

Written Statement
Prepared by Kentucky Farm Bureau Mutual Insurance Company
for the
Hearing on “National Flood Insurance Repetitive Losses”
before the
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Economic Policy
March 25, 2004

Chairman Bunning, Ranking Member Schumer and other subcommittee members, Kentucky Farm Bureau Mutual Insurance Company (KFB Insurance) on behalf of the Property Casualty Insurers Association of America (PCI) appreciates the opportunity to testify before the Senate Banking Subcommittee on Economic Policy regarding the National Flood Insurance Program. KFB Insurance and PCI strongly support a multi-year reauthorization of the federal flood insurance program.

PCI, an association formed in January with the merger of the National Association of Independent Insurers and the Alliance of American Insurers, represents over 1000 member companies that write over \$154 billion in direct annual premium, almost 40 percent of the U.S. property and casualty market. KFB Insurance, a mutual insurance company owned by its policyholders, is representative of much of PCI's membership. We welcome the opportunity to comment and hope that the comments that follow help to explain the importance of the National Flood Insurance Program to your constituents across America.

Kentucky Farm Bureau Mutual Insurance Company

Kentucky Farm Bureau Mutual Insurance Company is a member service of the Kentucky Farm Bureau Federation, an organization of families across

Kentucky, both rural and urban. The Kentucky Farm Bureau Federation has over 440,000 members in Kentucky. In the 1940's, the Kentucky Farm Bureau recognized the need for affordable insurance with prompt and fair claim service for its members; hence the birth of the Kentucky Farm Bureau Mutual Insurance Company. From our humble beginnings of providing insurance needs from a card table in a feed store, KFB Insurance has grown to be the largest property and casualty insurance company based in Kentucky.

- We are the largest in total premiums written in Kentucky.
- We are the largest in property insurance premiums written in Kentucky. We insure more residential property – homes, farms, mobile homes, and apartments – in Kentucky than any other insurer. We have nearly 304,000 personal property policies.
- We insure more cars in Kentucky than any other insurer. We write nearly 700,000 automobile insurance policies.
- We are the largest volume insurer of farm property in Kentucky.
- We are the second largest volume homeowner insurer in Kentucky.
- We are the fifth largest commercial writer of business in Kentucky, specializing in small businesses and family businesses.
- In 2002, we serviced nearly 158,000 claims.

KFB Insurance only writes business in the Commonwealth of Kentucky. We are representative of many of the Farm Bureaus across America that offer insurance services to consumers in only one state or a few states. Our strength

lies in our relationships with and presence in the local communities across Kentucky. We firmly believe that consumers want to deal with professional insurance agents and claimspersons, who are members of their communities, whether that community is a rural county or an urban neighborhood. Customers desire to deal with people with whom they have relationships.

Kentucky also has a very diverse and competitive insurance market. We have over 200 companies authorized to write property and casualty business in Kentucky, ranging from the strong national companies, such as Allstate, to the smaller local niche companies like Kentucky Growers. We believe strong marketplace competition serves consumers' best interests. KFB is a single state writer and serves a critical need in the insurance market. Because of our knowledge of the Kentucky market and our presence throughout Kentucky, we assist in keeping the Kentucky insurance marketplace available and affordable. Reauthorizing the NFIP plays an important role in maintaining this effective marketplace.

The Importance of the National Flood Insurance Program

The National Flood Insurance Program (NFIP or program) was created in 1968 because of severe and catastrophic losses resulting from floods. Flood insurance is offered through the Federal Emergency Management Agency (FEMA), now part of the U.S. Homeland Security Department. The program is significant, both for consumers and insurers, such as KFB Insurance. The NFIP

allows for available and affordable coverage for consumers for catastrophic and widespread flood losses. The program partners with the insurance industry to distribute and service the program. Finally, after losses, by partnering with communities and lending institutions, the program enforces and encourages mitigation of future flood losses.

Available and Affordable Flood Coverage

The program was originally established because the federal government and private insurers recognized the widespread catastrophic loss potential of floods. The federal government recognized that private insurance companies lacked the resources to identify all the flood-hazard areas (the mapping) and were unable to measure the potential loss. Furthermore, these catastrophic losses could not be sustained by private industry alone without becoming prohibitively expensive or simply unavailable for consumers.

The federal government undertook the job of classifying flood-hazard areas. Mapping the entire United States for flood zones took roughly six years. Most flood insurance rating maps (pre-FIRM) dates are 1974. Many maps have been updated or revised in the 30+ years the program has been in existence, and the NFIP is currently undertaking a seven-year project to re-map, using more sophisticated techniques (such as geo-coding), the entire United States. While mapping may have helped make floods more predictable and measurable, fully 25 percent of all the flood losses (according to the NFIP) occur in areas outside

of the existing 100-year mapped floodplains. This fact reinforces the widespread nature of this type of catastrophic loss and reinforces the need to continue the re-mapping project underway.

The NFIP serves a critical function for an insurance carrier such as KFB Insurance. If no federal program existed and flood insurance became a private sector responsibility, flood insurance would either be unavailable or unaffordable for consumers. Insurers base their rates on predictability of risk. Insurers distribute the propensity for loss among many policyholders making the coverage affordable for all. For example, when a KFB insured has a loss due to a hailstorm or tornado, all KFB insureds pay for the loss. However, while such events as hailstorms or tornados are unpredictable, they typically will not result in widespread catastrophic loss. Floods, on the other hand, are typically more catastrophic and more regionally predictable. For example, history teaches us that floods will likely occur in Kentucky, from the mountains of eastern Kentucky to the great Ohio and Mississippi Rivers in the north and west. Running water abounds in Kentucky, and it is likely that flooding will occur and be catastrophic in nature affecting many consumers.

Private insurers, like KFB Insurance, are an integral part of the competitive markets in each state; however, a one-state operation like ourselves could not adequately spread the risk of loss from these potential floods to policyholders nor absorb the losses when they occur. The NFIP, on the other hand, spreads this risk across the entire country based on floodplain exposure levels, making the

product more affordable for all. If the flood program were shifted to the private sector, to insurers such as KFB Insurance, one of two things would happen:

- Insurers would need to charge extremely high premiums to cover the flood exposure making flood coverage unaffordable, thereby making consumers uninsured for flood losses.
- The risk would be prohibitive, so insurers would not write and flood coverage, thereby making consumers uninsured for flood losses.

A Practical and Effective Distribution and Service Network

Another advantage of the NFIP as set-up today is that the federal government partners with carriers like KFB Insurance to sell flood insurance when a customer is purchasing all of their insurance needs. In other words, the federal government assumes the premiums and losses of the program, yet the distribution and servicing network of the program is through the local companies and their agents and adjusters. This fits well within the KFB Insurance framework, policyholders purchasing needed affordable coverage through persons in their community with whom they trust and have a relationship. Simply, more consumers purchase the needed coverage, thereby allowing society to rebuild after catastrophic losses.

After Loss Partnering to Rebuild and Mitigate Future Loss

The program also encourages mitigation efforts to reduce future losses, while partnering with the financial lending sector to rebuild after losses. We, as a society, value the amenities, business opportunities, and lifestyle of property close to water. The NFIP helps building efforts near water, but requires that rebuilding efforts be done with an eye toward mitigating flood losses in the future. The NFIP helps to strike the balance between our desire as a society to be close to water and the practical necessity of ensuring that flood losses are minimized.

Local communities must adopt sound land use policies or floodplain management ordinances. If these local municipalities do not adopt such plans and submit these plans to the government for approval, the municipality cannot participate in the NFIP. If they cannot participate in the NFIP, they simply lack the resources to rebuild.

The existence of the NFIP has allowed communities to develop the land in some flood-prone areas (with the buildings properly elevated). This would not have been possible in the private insurance marketplace as the risk of loss would have been too great and without some incentive, buildings would have been put, even more than they already are, in harm's way.

The NFIP also encourages more property owners in floodplains to purchase and pay for flood insurance. Since 1973, any federally-backed mortgage (for example through FHA, VA, SBA, FreddieMac, or FannieMae) on a property in a floodplain (an area located in the 100-year flood plain), must

purchase and maintain flood insurance. Mortgage lenders are required to make sure that the insurance is purchased and maintained on the property. This furthers society's desire to have buildings near water, but requires those individuals to pay premiums to insure that property.

The U.S. economy is just now getting back into a growth mode; however, the housing market has remained very strong, even through the recent downturn. Long-term reauthorization of this well-established program is vital to the U.S. economy, new and existing home purchasers, mortgage lenders and the insurance industry.

Program Improvement – Repetitive Loss

There are several ways the program could be improved. We would support, because of the high-cost of continually repairing or replacing repetitive loss structures, an expansion of the FEMA program that purchases these properties (at a fair-market cost) to reduce the costs to the program. We would also support charging these repetitive loss properties the true "risk-based" premium, based on sound actuarial principles, if the property owner or the community is not willing to relocate or sell the property. Repetitive losses account for almost 30 percent of all losses paid by the NFIP on an annual basis while the most costly of these repetitive losses (those where the loss has exceeded the building value in a 10-year period – 10,000 properties), amount to just over half of one percent of the 4.4 million flood insurance policies.

In addition, we support including language clarifying federal court jurisdiction over lawsuits arising out of NFIP in comprehensive legislation affecting the program.

We would be happy to discuss repetitive loss or jurisdictional issues with any of the committee members or their staff; however, support of the reauthorization is the primary purpose of my appearance here today.

Summary

There is a delicate balance between the federal government and the private insurance industry on several insurance-related programs that must be preserved. Programs such as federal crop and crop-hail insurance, terrorism reinsurance, the Price-Anderson Act for nuclear liability, federal deposit insurance and the NFIP, exist because of the truly immeasurable (from both a frequency and severity viewpoint) risks associated with these types of losses. We believe only the federal government has the resources to address these risks.

As evidenced by letters sent last year on behalf of the industry, this program is vital to a diverse and competitive property and casualty insurance market. We understand that the current program will end June 30, 2004, without reauthorization. This is the beginning of the hurricane season (June 1) and the height of the real estate season, thus, we would strongly encourage Congress to act and extend this program for a minimum of five years (if not permanently). We

would also recommend that Congress provide the authority to modify existing regulatory provisions and coverages to address legal and consumer issues. Finally, we would encourage Congress to fund a pilot program for repetitive losses.

Again, on behalf of the Kentucky Farm Bureau Mutual Insurance Company and PCI, we appreciate the opportunity to comment on the importance of the National Flood Insurance Program.