Testimony of
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Good morning Chairman Carper, Ranking Member Shelby, and Members of the Committee. I am David Maurstad, Assistant Administrator for Mitigation and Federal Insurance Administrator for the Federal Emergency Management Agency (FEMA) within the Department of Homeland Security. I appreciate the opportunity to appear today before the Committee to discuss the status of the National Flood Insurance Program (NFIP).

This morning I would like to provide a context for how the NFIP has moved forward since Hurricanes Katrina, Rita and Wilma made landfall in 2005. As you know, the NFIP was established in 1968 to make affordable flood insurance available in communities that would adopt and enforce measures to make future construction safer from flooding. From 1968 through 2004, a total of $15 billion had been paid out to cover more than 1.3 million claims. From 1968 through 2004, the NFIP took in $20.5 billion in Earned Premium.

Following the June 2004 signing of the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, the United States experienced back-to-back catastrophic hurricane seasons. The 2004 hurricane season resulted in over 75,000 claims totaling a record payment of over $2 billion. That record fell in 2005 when Hurricane Katrina resulted in claims to date totaling over $16.3 billion – over eight times that of 2004 and surpassing, by over a billion dollars, the aggregate amount of all claims previously paid in the nearly 40-year history of the NFIP.

Combined claims from 2005 Hurricanes Katrina, Rita, and Wilma total over $16.5 billion. This past June, Ed Connor, my Deputy Administrator for Insurance, testified before the House Financial Services Committee that we expected the total NFIP payout (claims and associated expenses) for the 2005 hurricane events to be approximately $20 billion. We have reexamined this calculation based on actual claims and payments to date, and we still consider this to be our best estimate.

The large number of claims and severity of flood losses from the 2004 and 2005 hurricane seasons are unprecedented in the history of the NFIP. The challenges these storms have presented to the NFIP, particularly the 2005 hurricane season, – in terms of flood insurance claims handling, floodplain management, flood hazard mapping and mitigation planning and grants management – have never been encountered, on this scale, before.

However, policyholder claims have been resolved expeditiously. By the summer of 2006, over 98 percent of our Katrina and Rita insurance claims had been closed – a volume that far exceeded the highest number of claims filed from any single event in the NFIP's history, and more than triple the total number of claims filed in 2004. Given the magnitude of these storms, our industry partners – Write-Your-Own (WYO) insurance companies, as well as claims adjusters and agents – fulfilled their responsibility effectively to help NFIP policyholders begin to rebuild their lives.

This introduction serves as a backdrop for the NFIP topics I will highlight this morning: (1) the NFIP's financial status; (2) how the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (Reform Act) has enabled the NFIP to operate more effectively; and (3) opportunities to fundamentally strengthen the NFIP's financial underpinnings.

NFIP Financial Status

The NFIP's financial status revolves around a variety of interrelated factors, issues, and events, including: (a) NFIP growth in terms of policies and assets; (b) catastrophic flooding; and (c) the NFIP's borrowing authority and its Katrina-related debt.

NFIP Status

The extremely active 2004 and 2005 hurricane seasons raised the Nation's awareness of the flood risks we all face. This activity, along with NFIP marketing efforts, has resulted in dramatic NFIP growth over the past three years. At the beginning of July 2007, the NFIP had almost 5.5 million policies for homes, businesses, and other residential and non-residential property, representing an increase of 5.8 percent from July 2006. The Program now insures in excess of $1 ***trillion*** in assets, a 13.2 percent increase over the past 12 months. The NFIP collects more than $2.5 billion annually in premiums and fees.

NFIP Solvency and Catastrophic Flooding

It is important to note that NFIP rate schemes are not designed to, in aggregate, cover catastrophic events or years, although the premiums for most properties already consider the potential for catastrophic losses. Over the years, the NFIP set premium levels to provide total program revenue covering the average, non-catastrophic loss year, plus expenses associated with administering the Program. Most of the NFIP's 2005 claims resulted from the damages caused by Hurricane Katrina, with levee failures vastly increasing the number of claims in New Orleans – circumstances not envisioned at the NFIP's inception, but from which the Program continues to learn as we work to get stronger.

Katrina-related flooding elevated our already-heightened concern about rate discounts and their affect on the Program's solvency. The NFIP provides insurance at actuarial (risk-based) rates for newer construction, with the majority of policyholders paying full actuarial rates. However, by statute, structures built prior to the mapping and implementation of NFIP floodplain management requirements are considered pre-Flood Insurance Rate Map (Pre-FIRM) buildings. Many Pre-FIRM buildings – which make up 24 percent of all NFIP policies – are charged heavily-discounted rates on the first $35,000 of the structure's insured value, and full risk-based rates for the remaining insured value. Those Pre-FIRM building owners with discounted NFIP policies are paying, on average, only 40 percent of a full risk-based premium – while the NFIP considers the remaining 60 percent as forgone revenue that is ***not*** passed on to other NFIP policyholders.

NFIP Borrowing Authority and Current Debt

From 1986 until the 2005 hurricane season, the NFIP was self-supporting. During periods of high losses, the NFIP is authorized to borrow from the U.S. Treasury. This borrowing authority is an essential part of the NFIP's financial design because it provides the Program with the resources needed in those years where claims exceed average annual historic loss levels. This authority enables the program to borrow limited amounts from the Treasury on occasions when income is not sufficient to cover claim payments and related costs. The loans from the Treasury are repaid, with interest, from policyholder premiums and related fees. Also, it is important to remember that, unlike the private insurance market, the NFIP premiums are based on expected losses in an average year as observed historically. This means premium levels set so that long run surpluses will equal zero, absent a catastrophic loss year or series of such years.

As stated earlier, I expect total payouts for the 2005 hurricanes to come close to $20 billion. Since Hurricane Katrina struck the Gulf Coast, Congress has increased the NFIP's borrowing authority three times to the present limit of $20.775 billion. To date, the NFIP has borrowed $17.535 billion to pay for Hurricane Katrina claims and for the interest payments due on that borrowing. Annual interest on Katrina-related borrowing will likely exceed $800 million by 2009 – the year we expect to approach our current borrowing limit.

Clearly, the 2005 flooding events were of a magnitude far beyond the ability of policyholder premiums to cover. The Program’s additional borrowing authority has been a critical element of our ability to fulfill the promise we made to our policyholders, allowing FEMA to resolve nearly all (over 98 percent) of the Katrina, Rita, and Wilma claims received to date. However, under current loan obligation arrangements – with the NFIP needing new loans at least every six months to cover semi-annual interest payments – it is unlikely that the Program will ever be able to retire its debt.

The 2004 Reform Act and NFIP Operations

In the aftermath of Hurricane Katrina, the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (Reform Act) proved to be instrumental in our ability to effectively inform and help Gulf Coast policyholders, and it continues to be a catalyst for programmatic success and improvement. We began implementing Reform Act changes during the 2004 hurricane season, and we have since improved NFIP delivery by implementing a number of initiatives directed by this Committee in the 2004 Reform Act: (a) distributing the ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook*** to policyholders; (b) issuing informative supplemental policy coverage forms with new and renewed flood insurance policies; (c) providing acknowledgement forms to flood insurance policy purchasers; (d) implementing important agent-training initiatives, (e) adopting a flood insurance claims appeals rule, and (f) carrying out initiatives that address repetitive loss properties.

<u>New Materials</u>

Increasing risk awareness among homeowners and consumers with improved, succinct information is a basic NFIP principle and one of the Reform Act’s most important elements. FEMA’s aggressive education and outreach campaign is continuously designing and upgrading informational material to increase the public’s awareness of flood risks and to keep our policyholders well-informed.

FEMA distributes the ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook*** to NFIP policyholders to help them through the claims process. These easy-to-understand materials are distributed to all policyholders when they purchase a policy, when they renew a policy, and when they file a claim. Additionally, FEMA and the Write Your Own insurance companies that participate in the NFIP distribute these materials in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers – as well as in town Hall Meetings – as soon as possible after storms strike. Without a doubt, the ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook*** have been invaluable additions to the Program and have played a major role in FEMA’s ability to close claims quickly and fairly.

<u>Supplemental Forms</u>

The NFIP now issues supplemental forms with each flood insurance policy. These forms provide, in layman's terms, information that helps policyholders clearly understand their flood insurance coverage, such as: exact coverage purchased; exclusions from coverage; and explanations – with illustrations – of how the policy values lost items and damages. The NFIP gives these easy-to-understand forms to all flood insurance policyholders at the time of purchase and renewal, and to all insurance companies and agents authorized to sell NFIP flood insurance.

Acknowledgement Forms

The NFIP also provides flood insurance policy purchasers with an acknowledgement form. By signing this form, policyholders acknowledge receipt of the standard flood insurance policy and related supplemental material, and indicate that they understand what is and is not covered under the policy.

Training Agents That Sell Flood Insurance

Training for insurance agents that sell flood insurance continues to be a high priority for the NFIP. On September 1, 2005 FEMA published a notice entitled Flood Insurance Training and Education Requirements for Insurance Agents in the Federal Register (see 70 Fed. Reg. 52117). We have been coordinating with the States, the insurance industry, and related associations to inform our stakeholders of these requirements. To date, 42 States and the District of Columbia have made flood insurance training mandatory for agents that sell NFIP coverage. FEMA is encouraged by the continued growth of classroom and online training participation. So far, over 42,000 insurance agents have earned 3 hours of continuing education credits by completing our Basic Agent Tutorial either online or in the classroom.

Of course, FEMA would like to see all States make flood insurance training mandatory for agents. We have encouraged the States with minimum training and education criteria to place these requirements in their licensing and continuing education programs, and we will provide technical assistance and resources to all the States as appropriate. One such resource is Agents.FloodSmart.gov. As part of our highly successful FloodSmart marketing campaign, this website provides extensive information for flood insurance agents, including links to educational and training programs.

Claims Appeals

FEMA's Flood Insurance Claims Appeals Rule became effective November 13, 2006. This Reform Act requirement formalizes a process through which flood insurance policyholders may appeal the decisions of adjusters, agents, insurance companies, and FEMA regarding claim settlements. The rule making speaks to the issue of mediation; and I emphasize that mediation is most effective when it occurs early in the claims process. I encourage companies that sell NFIP flood insurance to make, or continue to make, this alternative dispute resolution option available to policyholders. The NFIP continues to maintain its historically high success rate of resolving over 99 percent of its claims without litigation.

Currently, if a claim is denied, the insured may file an appeal directly with FEMA. The ***Flood Insurance Claims Insurance Handbook*** includes detailed instructions on how to file that appeal. This allows the policyholder to go directly to the NFIP to state their claims issues.

Addressing Repetitive Loss Properties

The 2004 Reform Act authorized a new Repetitive Flood Claims Program (RFC), which provides $10 million in annual funding to reduce or eliminate the long-term risk of flood damage to NFIP-insured structures. The Mitigation Directorate will distribute all FY07 Repetitive Flood Claim Program funds by selecting RFC property acquisition projects for 41 buildings. In

FY2006, the first year of the Program, $9.8 million was awarded for property acquisitions that purchased and removed 40 structures from floodplains.

Additionally, the Severe Repetitive Loss (SRL) Pilot Program is in its final stages of development. In fiscal years 2006 and 2007, FEMA transferred $40 million from the National Flood Insurance Fund to mitigate severe repetitive loss properties, which the Act defines as: properties that have experienced four or more flood losses of at least $5,000 each, with at least two claims payments occurring in a 10-year period, and with the total claims paid exceeding $20,000; or properties that have received at least two separate flood claims payments, where the cumulative flood claims payments exceed the value of the property. The FY 2008 President's Budget contains $80 million for the SRL program. FEMA is developing the SRL program regulations, guidance and administrative documents necessary for implementation; and once the regulations are published in the *Federal Register*, FEMA will provide guidance to potential applicants and will begin awarding funds. In July, FEMA sent letters to all State Hazard Mitigation Officers and NFIP Coordinators to inform them of how to retrieve SRL property information in their respective states, so they could identify communities with SRL properties as potential partners for this grant program.

Both RFC and SRL build on our Flood Mitigation Assistance Program (FMA). FY07 funding for this long-standing floodplain management program was $31 million, as opposed to $20 million in past years. These funds have been committed to projects and plans, and FEMA Regions are working closely with the States to obligate the money. For FY 2008, the President's budget has requested an additional $3 million to bring the program up to $34 million. All three of these mitigation programs – RFC, SRL, and FMA – play an important role in FEMA efforts to reduce repetitive loss structures and eliminate the flood-rebuild-flood cycle that residents in the Nation's flood-prone areas have become so familiar with.

Strengthening the Program

Significant flood events have played major roles in the NFIP's evolution: the Program was created after Hurricane Betsy carved a swath of destruction through the Gulf Coast in 1965; Tropical Storm Agnes provided the impetus for the 1973 Flood Disaster Protection Act, which introduced mandatory purchase requirements; and the 1993 Midwest Flood was the catalyst behind the National Flood Insurance Reform Act of 1994 and its stronger lender compliance requirements. It is entirely appropriate, therefore, that the catastrophic 2004-2005 hurricane seasons result in an examination of how the NFIP can be improved – programmatically and operationally.

<u>Programmatic Improvement</u>

Since the end of the 2005 hurricane season, in Congressional hearings and in presentations at various events nationwide, the Mitigation Directorate and the NFIP have outlined the following fundamental mitigation and insurance principles:

- The NFIP must fulfill all obligations and commitments;
- Phase out discounted premiums in order to charge policyholders fair and actuarially sound premiums;
- Increase NFIP participation and improve enforcement of mandatory participation in the program;

- Increase risk-awareness among homeowners and consumers by improving information quality; and

- Reduce risk through combinations of proven mitigation practices and explore opportunities to reduce risks through enhanced protective measures.

Now is the time to complement our mitigation and insurance principles with several NFIP enhancements. To strengthen the NFIP, and to foster our commitment to reduce the Nation's flood risks, we believe Congress and all NFIP stakeholders should consider the following NFIP adjustments:

- Provide authority to eliminate premium discounts over time for properties built before flood insurance rate maps were in place, particularly for other than primary residences.

- Increase the penalties for Federally-regulated lending institutions that do not comply with their mandatory purchase regulatory responsibilities.

- Require a study of the feasibility and implications of expanding the standard for mandatory flood insurance purchase requirement to include properties in areas of residual risk – structures protected by levees, dams, and other manmade structures;

- Provide for additional Increased Cost of Compliance (ICC) coverage – money for NFIP policyholders to bring their structures up to existing flood-related building codes-- that is in addition to available building limits. Remove the $75 cap on ICC premiums so that a variety of ICC options can be offered to the policyholder.

However, we oppose provisions that would increase the scope of coverage offered by the flood insurance program. Increasing the coverage amounts could encourage expensive development in high-risk areas.

<u>Operational Improvement</u>
The September 2007 GAO report ***"FEMA's Management and Oversight of Payments for Insurance Company Services Should Be Improved"*** recommends that FEMA take steps to ensure that it has a reasonable estimate of the actual expenses WYO Companies incur and that financial audits are performed.

Since 1983, the NFIP has worked with the insurance industry to ensure that WYOs expenses are compensated fairly for the invaluable services they provide. WYO compensation has always been based on the actual operating expenses insurance companies incur while selling and servicing policies for other lines of property insurance. The NFIP has used this methodology for almost 25 years, and its results continue to be fair, timely, and consistent with other insurance industry expenses. In fact, operating expenses, as noted in the GAO report, have declined over the years. From 1996 to 2005, average underwriting expenses (as a percentage of premium income) have dropped two percent.

FEMA is working with the National Association of Insurance Commissioners to strengthen reporting requirements of industry expenses incurred in selling and servicing flood insurance policies. Additionally, FEMA is working with the industry to acquire their loss adjustment expenses – a component of their overall expense structure. FEMA also is developing additional oversight guidance for our insurance industry partners. FEMA is committed to effectively performing these important WYO biennial audits; they are extremely valuable to the NFIP, and they will be – without exception – carried out when they are supposed to be. The NFIP's Financial Management team has implemented an audit tracking and follow-up system, and the deadline to receive all 2005-2006 biennial audits was September 30, 2007.

Conclusion

The 2005 hurricane season presented the NFIP with numerous challenges on a variety of fronts, providing avenues for financial, legislative, programmatic, and operational improvements that are critical to the NFIP's continued success. Such improvements, when integrated into comprehensive mitigation strategies at the Federal, State, and community levels, will benefit policyholders, our stakeholders, NFIP communities, and the Nation. However, I want to emphasize that there is no quick solution that will enable this important Program to absorb catastrophic loss years.

I look forward to continuing to work with this Committee, our NFIP WYO companies, agent groups, and other partners to strengthen the National Flood Insurance Program and reduce the Nation's vulnerability to all natural hazard events. I will be happy to answer any questions that the Committee might have. Thank You.