Testimony of Steve Ellis

Vice President, Taxpayers for Common Sense

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
hearing on
"Legislative Proposals to Reform the National Flood Insurance Program"

March 11, 2011

Good morning, Chairman Biggert, Ranking Member Gutierrez, members of the subcommittee. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog. Thank you for inviting me here today to testify on reform of the National Flood Insurance Program (NFIP).

Taxpayers for Common Sense has advocated for reform of the National Flood Insurance Program since our inception sixteen years ago. This time is easily divided into two sections. The first ten years our concerns about the program's subsidies and underlying risk to taxpayers were met with skepticism from many quarters. But after the devastating hurricane season of 2005 and with the nearly $18 billion the program is in debt to the Treasury, all have recognized NFIP is fundamentally flawed and must be reformed. The question is how.

Any reauthorization of the National Flood Insurance Program must make significant changes to put it on sounder financial footing, and help it climb out of its budgetary hole with more actuarially sound rates and accurate maps. The discussion draft of reform legislation being circulated by the committee is a good start. It responsibly tackles rate and subsidy issues, creates a mechanism to increase confidence and accuracy in flood mapping, and doesn't stick taxpayers with the tab of bailing out a failed program. However, we are concerned with provisions that could inhibit adoption of updated maps, add a new business line to the program, and mandate annual coverage limit increases that will ensure the program's liabilities actually increase each year. We look forward to making this good start an even better final product and applaud the committee for taking this up early in the session, increasing the likelihood that a reform measure will pass this Congress.

TCS is allied with SmarterSafer.org, a coalition in favor of environmentally responsible, fiscally sound approaches to natural catastrophe policy that promote public safety. The groups involved represent a broad set of interests, from free market and taxpayer groups to

environmental and insurance industry groups.[1] The depth and breadth of the coalition underscores the importance of reforming NFIP. I would like to submit for the record SmarterSafer.org's principles for reform of the National Flood Insurance Program.

As they say, those who ignore history are doomed to repeat it. When looking at the reforms, it is important to look at the mistakes that saddled taxpayers with a flood insurance program that is $18 billion in debt[2] and only has annual revenues of $3.1 billion.[3] Even if you exclude ridiculously low interest payments and administrative costs, it would take more than six straight years with no claims to pay the debt back. Obviously, this isn't going to happen.

This is also about fundamental fairness within the flood insurance program and eliminating the cross subsidies that have a few properties paying full freight while picking up the tab for properties that have enjoyed subsidized premiums for decades.

Unintended Consequences

After years of ad hoc disaster aid being meted out by Congress, the National Flood Insurance Program was established in 1968 to create "a reasonable method of sharing the risk of flood losses through a program of flood insurance which can complement and encourage preventative and protective measures."[4] The program was to make up for a lack of available flood insurance. But even at that time Congress was warned that it was playing with fire. The Presidential Task Force on Federal Flood Control Policy wrote in 1966:

> A flood insurance program is a tool that should be used expertly or not at all. Correctly applied it could promote wise use of flood plains. Incorrectly applied, it could exacerbate the whole problem of flood losses. For the Federal Government to subsidize low premium disaster insurance or provide insurance in which premiums are not proportionate to risk would be to invite economic waste of great magnitude.[5]

Well, we know which way that story unfolded. Although subsidies were largely envisioned to be limited and short-term, they weren't. And while the program has encouraged standards and construction that help reduce flood risks for participating communities, the availability of cheap federal flood insurance over the last several decades made it financially attractive to develop in

---

[1] Full list is available at www.smartersafer.org

[2] Statement of Orice Williams Brown, Director Financial Markets and Community Investment, Government Accountability Office before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives. April 21, 2010. P 1. Available at http://financialservices.house.gov/media/file/hearings/111/brown_4.21.10.pdf

[3] Congressional Budget Office. "The National Flood Insurance Program: Factors Affecting Actuarial Soundness." November 2009. P 1. Available at http://www.cbo.gov/ftpdocs/106xx/doc10620/11-04-FloodInsurance.pdf

[4] P.L. 90-448.

[5] U.S. Task Force on Federal Flood Control Policy. "A Unified National Program for Managing Flood Losses." August 1966. P 17. http://www.loc.gov/law/find/hearings/floods/floods89-465.pdf

high risk areas. Along with other factors, NFIP helped fuel the coastal development boom that increased the program's risk exposure and losses.

To foster increased participation, the NFIP does not charge truly actuarially sound rates, or increase rates based on previous loss experience. The program's goal of fiscal solvency is defined as charging premiums that will generate enough revenue to cover a historical average loss year.[6] That means catastrophic loss years are largely left out of the equation. The program covers any fiscal shortfalls by borrowing from the U.S. Treasury, which is a significant subsidy in itself, especially since the loans are virtually interest-free.

NFIP's fiscal solvency is further challenged because properties that pre-date a community's involvement in the NFIP or the applicable flood insurance rate map (whichever is later) enjoy significantly subsidized rates, paying only 35-40% of their actual full-risk level premium.[7] While the initial thought may be that because of their vulnerability these pre-FIRM (Flood Insurance Rate Map) properties wouldn't be long for this world, an analysis by *USA Today* found 1.2 million buildings receive these discounts.[8] FEMA puts the percentage of properties in the NFIP receiving explicitly subsidized rates as more than 20%.[9]

Furthermore, properties experiencing repetitive losses make up a disproportionate amount of the program costs. A repetitive loss property is one that has had two or more claims of $1,000 over ten years. These properties represent only one percent of the total number of policies, yet account for up to 30% of the cost of claims.[10] Properties like one in Wilkinson, MS that has flooded 34 times since 1978 and received payments worth nearly ten times the home's $70,000 value. Or another property owner in Houston, TX that has received $1.6 million worth of claims for a house worth $116,000.[11] We need to help these people out – out of harm's way – and at the same time help the taxpayer who is picking up the tab.

Committee Draft on Rates

The draft legislation provides a mechanism to move toward actuarial rates for many properties.[12] Also the increase of the deductible for pre-FIRM properties to $2,000 is appropriate.[13]

First the graduated phase in of rates for newly mapped areas is responsible for both the homeowner and the program. The draft legislation provides that for the first year the rate would be 50 percent of the total and then increase 20 percent annually after that until the full

[6] Hayes, Thomas L. and Neal, D. Andrew. "Actuarial Rate Review," Federal Emergency Management Agency. October 1, 2010. P.5.
[7] Congressional Budget Office. Supra Note 3 at 6.
[8] Frank, Thomas. "Huge Losses Put Federal Flood Insurance Program in the Red," USA Today. August 26. 2010. Available at http://www.usatoday.com/news/nation/2010-08-25-flood-insurance_N.htm
[9] Hayes and Neal. Supra Note 6 at 22.
[10] Brown. Supra Note 2 at 8.
[11] Frank. Supra Note 8.
[12] Sec. 5
[13] Sec. 4(b)(1)

rate is in effect. In addition, the legislation stipulates that commercial properties, second homes, newly purchased homes, substantially damaged or improved homes, and severe repetitive loss properties have their rates increased by 20 percent annually until they are paying the estimated risk premium rate. In addition the draft legislation directs that subsidies not be available to lapsed policies.

By and large all of these changes make sense and move the program in the right direction. Presumably, post-FIRM properties will pay appropriate risk-based rates as maps are revised and improved through the bills mapping improvement efforts. What appears to remain unchanged are pre-FIRM properties that do not meet any of the specific criteria remain subsidized. It is not clear how many properties or the potential losses this represents, but it is an area that must be reformed. These properties have been subsidized for decades.

Accurate Maps Are Critical

The NFIP is driven by maps. They determine the veritable alphabet soup of what flood zone your structure is in: A, V, X or variants within each category. Your property could be in the 100-year floodplain or the 500-year floodplain; high-risk storm surge zone or special flood hazard areas. Your property could pre-date the flood insurance rate map (FIRM) or otherwise be eligible for significantly subsidized premiums. The maps are key to the program's success or failure. They must be up to date, accurate and based on the best available science. This is why FEMA's map modernization program is so critical to the long term fiscal viability of the program.

The nation's floodplains are dynamic. Not just from natural forces, but also the impacts of development, weather patterns, and topographical changes. Areas that were previously less likely to flood could now be more likely. Levees that were adequate to provide 100-year protection a decade ago may provide far less due to poor maintenance or increased flood elevations due to increased runoff or new development.

Since 2003, FEMA has been working to update thousands of flood maps. In addition, levees are being reviewed and in some cases decertified for not meeting the required level of protection. According to FEMA, the nation's special flood hazard areas (SFHA) have grown in size by seven percent. While this revealed more land and housing is vulnerable to flooding, other areas are less vulnerable. In fact, the number of housing units in SFHAs has seen a net decrease of one percent.[14]

Not surprisingly, the map modernization effort has been met with some controversy. In some cases, homeowners are facing steep increases in premiums after many years of paying the same rate. While the uproar is understandable, it doesn't change the underlying circumstances

---

[14] Testimony of Craig Fugate, Administrator, Federal Emergency Management Agency, Department of Homeland Security before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives. April 21, 2010. P 4. Available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/fugate__4-21-10.pdf

or the risk. In some cases property owners that didn't have to purchase flood insurance under existing law now find themselves required to do so. But just because it isn't popular doesn't mean it's not the right thing to do. What isn't the right thing to do is ignoring the realities on the ground – literally – and not requiring flood insurance in these instances. Because it means when the inevitable floodwaters appear, the homeowner will not be covered by their regular insurance and the taxpayer will be asked to open up their wallet to bail them out. In fact in many cases it makes sense for the homeowner to purchase flood insurance even if they are not required to do so.

It may be politically expedient and popular to delay map modernization or waive building standards. But what may make good politics generally makes bad insurance policy -- and by extension with federal flood insurance – bad public policy. People deserve to know the cost and risks of where they live. And taxpayers deserve to have those who choose to live in harm's way pick up their share of the tab.

Committee Draft on Mapping

The draft legislation establishes a flood mapping advisory council[15] to develop new standards for flood insurance rate maps that would incorporate true risk, be graduated and reflect realities on the ground – both man-made and natural. The broad membership and public outreach required are critical for a successful effort that has the buy-in of all affected constituencies. In addition, the direction that FEMA implement the new protocols[16] is critical. The requirement that rate maps be graduated to at least include not only the 100-year floodplain, but also the 250-year, residual risk areas, and possibly be graduated further, is a major step in the right direction for both the fiscal health of the program and informing the public of the actual flood risk to their property.

Just to be clear, the council and the development of new mapping standards should not and will not delay map modernization – that critical next step should continue. This will just provide for better, even more detailed maps in the future.

We appreciate that unlike the bill passed by the House last year, the draft legislation does not automatically delay the implementation of new maps and excessively slow walk rate increases. However, provisions in the draft legislation could potentially delay or undercut the effects of the new maps. The draft gives the Administrator authority to suspend flood insurance purchase requirements for areas that new maps place in special flood hazard areas. It is unclear of the full effect of this provision since lenders could (and likely would) require purchase for properties in their loan portfolio. Regardless, insulating people from the changes related to the maps does not change the geological realities – their property is at risk.

People need to be informed of their flood risk and take steps to financially protect their own investments. To manage that risk, people should purchase flood insurance, if Congress wants to ease the transition then a phase-in of rates is appropriate. It is also unclear how this provision

---

[15] Sec. 6

[16] Sec. 7

would affect the restriction that properties in covered floodplains that do not purchase flood insurance are ineligible for disaster relief.

Don't Make Matters Worse

In years past there have been efforts to expand the National Flood Insurance Program or create new insurance areas for the federal government. One is the addition of wind insurance, which was wisely – and soundly – rebuffed by the Senate in 2007. We appreciate that the legislation didn't include this provision. It simply doesn't make sense to add a whole new business line to the already challenged flood insurance program.

However, there are some troubling potential expansions of the program in the draft bill. One is the creation of a new insurance product for business interruption or loss of use of personal residence.[17] The former would provide coverage up to $20,000 per property and the latter up to $5,000. With the flood insurance program so heavily in debt it doesn't make sense to expand the coverage provided. While the draft legislation directs the Administrator to not provide the coverage if a competitive private insurance market for it is available, we have learned from federal flood insurance itself that the best way to stifle a private market is to have the federal government provide the same product.

Similarly, the provision in the draft bill that would enable the coverage limits to annually increase by some inflationary measure[18] would result in taxpayers being on the hook for potentially higher and higher loss levels and stifle the development of a secondary insurance market. In addition, it would be very hard to administer. As we have seen over the last several years, residential markets and fluctuations in home values vary dramatically across the country. It doesn't make sense to basically lock in coverage increases annually. One way to move toward a more robust private flood insurance market is to allow the secondary market to provide additional coverage to develop. This provision could easily squelch that.

Conclusion

From Taxpayers for Common Sense's standpoint, there is more that can be done to improve the program. We support the privatization study called for in the legislation, and encourage FEMA to pursue the private-risk management initiatives. It would also be helpful to authorize FEMA to develop a catastrophic reserve to help smooth out minor loss and surplus years without resorting to borrowing.

There must be a strong commitment to help communities and individuals to reduce their flood vulnerability, including stronger standards for floodplain management and mitigation. Congress should end the problem of repetitive loss properties with elevation and relocation programs, increase the availability of accurate information about flood risks, and ensure adequate enforcement of program rules. In too many cases it appears that communities or property owners have skirted existing rules and rebuilt more than 50% of the property while retaining subsidized rates.

---

[17] Sec. 4 (c)

[18] Sec. 4 (b)

The National Flood Insurance Program is in trouble and is at a crossroads. The shaky foundation on which it was based has enormous cracks. Congress and the administration can either remake and strengthen that foundation by putting the program on more solid financial footing, or create even greater cracks by adding new business lines or delaying a shift to actuarial rates and updated flood maps.

On balance, the draft legislation is a good step forward to reform the troubled flood insurance program. We look forward to working with the Committee and Congress to move the program in the right direction and off the backs of taxpayers.