

**Testimony of
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Before
The United States Senate
Committee on Banking, Housing, and Urban Affairs
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Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I am David Maurstad, Acting Mitigation Division Director 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), particularly after the devastating effects of last year's hurricane season.

As I did during my October testimony before this Committee, I would like to provide a context for what the NFIP is facing as a result of Hurricanes Katrina, Rita and Wilma. 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. Since the NFIP's inception in 1968 through 2004, a total of \$15 billion has been paid out to cover more than 1.3 million losses. Simultaneously the NFIP's floodplain management efforts are now reducing the potential losses from floods by an average of \$1.1 billion a year.

Since the June 30, 2004 signing of the Flood Insurance Reform Act (FIRA04), this country has experienced back-to-back catastrophic hurricane seasons. The 2004 hurricane season resulted in over 75,000 claims totaling close to \$2 billion dollars paid out in NFIP coverage. The 2005 hurricane season has resulted in payments totaling over \$13.5 billion to date – nearly matching the total amount paid out over the NFIP's 37-year existence.

From 1986 up until the 2005 hurricane season, the NFIP has been self-supporting. During periods of high losses, consistent with the law, the NFIP has borrowed from the U.S. Treasury. Our authority to borrow from the Treasury is an essential part of the NFIP's financing design for heavy loss years. This authority enables the program to borrow limited amounts from the Treasury on occasions when income is not sufficient to cover losses and related costs. These loans have been repaid, with interest, from policyholder premiums and related fees, and at no cost to the Nation's taxpayers. Thus, the program has successfully provided economic resources to help individuals and businesses recover from flood disasters. Without this program, the demand on the Disaster Relief Fund and other Federal relief programs would be extreme.

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 Mitigation Division, 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.

Yet, the NFIP continues to effectively operate as intended. In the nearly five months since Hurricanes Katrina, Rita, and Wilma struck the Gulf Coast, the NFIP has resolved over 70 percent of the 239,000 claims filed from these events. This volume far exceeds the highest number of claims filed from any single event in the NFIP's history, and is more than triple the total number of claims filed in 2004. Our industry partners, the Write-Your-Own (WYO) insurance companies, claims adjusters and agents, have more than fulfilled their responsibility to help policyholders begin to rebuild their lives.

We are fulfilling the promises we made to our policyholders and NFIP communities, and the NFIP is effectively serving our policyholders in the wake of the worst natural disaster this Nation has ever experienced. FEMA is proud of the NFIP's ability to provide good customer service to our flood insurance policyholders – people who had the foresight to do the right thing and protect their homes and businesses from the perils of flooding.

In October, I informed you that we expect the total NFIP payout (claims and associated expenses) for these events to be over \$23 billion – more than all of the claims paid in the entire history of the NFIP. We have reexamined these projections based on claims to date, and we still believe that these estimates are valid. As you will note in Exhibit 1, claims payments will exceed \$22 billion for Hurricane Katrina alone.

Today, my testimony will focus on the NFIP's financial and program status and options for strengthening the program.

NFIP Financial and Program Status

The NFIP currently insures in excess of \$800 billion in assets. This covers more than 4.8 million policies for homes, businesses, and other non-residential property owners. Each year the NFIP collects approximately \$2 billion in premiums and fees. As previously stated, \$15 billion has been paid out since the NFIP's inception through 2004 to cover more than 1.3 million losses. Many of these claims occurred as a result of smaller flood events that did not rise to the level of a Presidential disaster declaration and for which Federal disaster assistance was unavailable. Yet these property owners endured as much of an individual loss as those in larger events. In this regard, studies have indicated that insurance is the most efficient and equitable method of providing disaster assistance.¹

The NFIP provides insurance at actuarial (risk-based) rates for newer construction, with approximately 76 percent of policyholders paying actuarial rates. For structures built prior to the mapping and implementation of NFIP floodplain management requirements

¹ See GAO Report, PAD-80-39.

(approximately 24 percent of the policies), heavily subsidized rates are charged on the first \$35,000 of insured value because flood risks were not fully known to the property owner when these structures were built. For these structures full risk-based rates are charged for limits beyond the first \$35,000 of coverage. On average, these policyholders are paying only 40 percent of a full risk-based premium.

As mentioned earlier, we anticipate that total borrowing for the 2005 hurricanes will exceed \$23 billion. Annual interest on such borrowing will exceed \$1 billion.

Congress increased the NFIP's borrowing authority to \$18.5 billion in November due to Hurricanes Katrina, Rita and Wilma. This additional borrowing authority has been a critical element of the NFIP's ability to effectively serve our policyholders, allowing FEMA to resolve three-quarters of the Katrina, Rita, and Wilma claims received to date.

Most importantly, as shown in Exhibit 2, NFIP projections indicate that flood insurance claims payments will reach the new \$18.5 billion borrowing limit by early- to mid-February 2006. The program will require an additional \$5.6 billion in borrowing authority to cover claims and expenses through FY 2006. Additionally, language in the 2006 DHS Appropriations Act limits interest payments to Treasury to \$30 million, which is not sufficient for the program to fulfill its interest obligations. In order for the program to meet its obligations to the Treasury, the interest cap needs to be waived or raised to at least \$670 million.

The 2004 Flood Insurance Reform Act was a catalyst for improvements to the NFIP. We began implementing these changes during the 2004 hurricane season and improved our delivery of them during the 2005 hurricane season. Our approach included expanded communication to increase awareness and effective processing of claims.

Increasing risk awareness among homeowners and consumers with improved, succinct information is one of the NFIP's basic principles, and is an important element of the 2004 Flood Insurance Reform Act. FEMA, through an aggressive education and outreach campaign, is continuously designing and upgrading informational material to increase the public's awareness of flood risks and to effectively keep our policyholders informed.

For instance, immediately following Hurricane Katrina, we distributed two documents to policyholders to help them through the claims process: The *NFIP Summary of Coverage* and the *Flood Insurance Claims Handbook*. These easy to understand materials are being distributed to all policyholders at the time of initial purchase, policy renewal, and at the time a claim is filed. In addition, these materials have been distributed in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers – as well as in Town Meetings – since September 1, 2005. I have personally handed these materials to State Insurance Commissioners in Alabama, Mississippi, and Louisiana, and we have distributed an informational CD containing these documents and other ready-to-print materials to field offices, State and local government offices, and the media.

Also, recognizing that a significant number of policyholders were displaced, FEMA has implemented several systems to reach policyholders early in the claims process. These systems have been particularly useful to those who are cut off from their usual sources of information and communication. For example, in the days immediately following Katrina, we cross-referenced a National Processing Service Center report of all callers who applied for disaster assistance and indicated they had flood insurance. We matched the addresses of damaged properties to NFIP policy addresses and connected insurance companies to their flood insurance policyholders. It has enabled the WYO Companies to reach out to their NFIP policyholders and help them immediately when they needed it most. This system will now become standard operating procedure in future flooding events.

We have also aggressively worked with the insurance industry to implement the minimum training requirements for all flood insurance agents who sell flood insurance. I have met with and given presentations to the National Association of Insurance Commissioners and the National Conference of Insurance Legislators on several occasions. We have also conducted three webcasts covering the NFIP and program improvements for state insurance commissioners and their staff. The training requirements were published in the September 1, 2005 *Federal Register*, and we are working with the States as well as the insurance industry and related associations to inform insurance companies and agents of these requirements.

These innovative materials, systems, and training initiatives carry out the provisions and intent of FIRA04, and the desire of the NFIP to reach out – with easy-to-understand information – to policyholders as early in the claims process as possible, recognizing that the sooner claims are settled, the sooner people can start rebuilding their lives and communities.

Given the unprecedented number of claims, widespread destruction, and the difficulties encountered by adjusters accessing the devastated areas, FEMA is especially appreciative of our insurance industry partners as we developed and implemented streamlined adjustment and claims processes designed to effectively serve policyholders.

Utilizing state-of-the-art aerial imagery, up-to-date water-depth data, and information from extensive underwriting files, the Write-Your-Own (WYO) insurance companies have been able to rapidly identify insured properties that have been washed off their foundations, have had standing water in them for an extended period, or have only pilings or concrete slabs remaining. In addition, FEMA waived proof of loss requirements and has fast-tracked claims up to the maximum insured value.

These streamlining methods have substantially reduced our normal adjustment times from what one would normally see under such extreme circumstances. Further, this process provided a mechanism for rapidly resolving claims within 60 days of the event. By November 1, over 30,000 claims had been handled through our expedited claims process, and over \$1.8 billion were made available to policyholders. From the

beginning, FEMA general adjusters and claims staff have been in the field re-inspecting sample sets of claims in order to ensure the integrity of the process.

FEMA is strongly encouraging Gulf Coast communities to assess and utilize all relevant, current technical resources and information available, including updated flood hazard information, in all planning, mitigation, and rebuilding efforts. Hurricanes Katrina and Rita had significant impacts on flood hazards in coastal Mississippi and Louisiana. Citizens are anxious to begin recovering, and updated flood hazard information is being provided to help guide reconstruction. At the request of Mississippi officials, FEMA provided the State with Advisory Base Flood Elevations to help rebuilding efforts for the State's three most heavily affected counties. In Louisiana, Advisory Base Flood Elevations were provided for 11 of the 15 parishes affected. As more information becomes available, FEMA will release it to communities. This phased data development effort will ultimately result in revised Digital Flood Insurance Rate Maps.

FEMA anticipates that preliminary Digital Flood Insurance Rate Maps (DFIRMs) will be issued for Mississippi by August 2006. Preliminary DFIRMs will be provided to the parishes and communities in Louisiana beginning in the fall of 2006. By early 2007 all impacted Louisiana parishes are scheduled to receive preliminary DFIRMs.

Strengthening the Program

Significant flood events have played a major role in the NFIP's evolution. The program was created when Hurricane Betsy carved a swath of destruction through the Gulf Coast in 1965. Tropical Storm Agnes in 1972 provided the impetus for the mandatory purchase requirements to increase participation in the program. The Midwest Flood of 1993 strengthened lender compliance requirements by introducing penalties for non-compliance with mandatory purchase provisions of the statute with the National Flood Insurance Reform Act of 1994. It is entirely appropriate, because of the 2004 and 2005 hurricane seasons, to once again examine ways to strengthen the NFIP.

In my October testimony before this Committee, I outlined the following mitigation and insurance principles:

- Protect the NFIP's integrity by covering existing commitments and liabilities;
- Phase out subsidized premiums in order to charge policyholders fair and actuarially sound premiums;
- Increase NFIP participation incentives 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 should consider the following NFIP adjustments:

- Provide authority to eliminate subsidies over time for properties built before flood insurance rate maps were in place, particularly for other than primary residences.
- Strengthen the mandatory insurance purchase requirement for Federally-regulated lending institutions to require insurance to value as opposed to the outstanding balance of the loan, and for the life of the loan, and to require more frequent and thorough portfolio reviews by lending regulators.
- Increase the penalties for Federally-regulated lending institutions that do not comply with their mandatory purchase responsibilities.
- Reduce the period of time a new policyholder must wait before an NFIP policy takes effect from 30 days to 15 days.
- Direct FEMA to study the feasibility and implications of expanding the standard for mandatory purchase requirement to include properties in the 0.2% chance per year floodplain (500-year flood plain) and 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.
- Direct FEMA to study the feasibility and implications of offering Additional Living Expense coverage and Business Interruption coverage.

A strengthened NFIP, combined with the implementation of a sound mitigation strategy, will provide even more support to NFIP policyholders and will continue to help communities reduce their vulnerability to flooding events in a cost-effective manner. According to a Congressionally mandated study recently released by the National Institute of Building Sciences, each dollar spent on disaster mitigation saves an average of four dollars. Mitigation, combined with a strengthened NFIP, results in significant benefits to society as a whole – to individuals, states, and communities. These benefits represent reduced economic losses, and significant savings to the Federal treasury.

Conclusion

The 2005 hurricane season has presented the NFIP with numerous challenges on a variety of fronts. However, it is important to remember that these challenges are not the result of a broken program; rather, they are the result of the most catastrophic back-to-back

hurricane seasons this Nation has ever experienced. The program has, for more than 37 years, through sound floodplain management, mitigation, and insurance, helped people recover from the devastation of floods while saving the nation more than \$1 billion annually.

The proposed changes to the NFIP, when integrated into a comprehensive mitigation strategy, will improve the program's economic and financial viability. However, I want to emphasize that there is no quick solution that will enable the program to absorb catastrophic loss years as we have just experienced.

In order to continue to meet existing claims, the program will need an additional \$5.6 billion in borrowing authority to cover claims and expenses through FY 2006. Additionally, the limitation on interest payments to the Treasury needs to be waived or raised to at least \$670 million for the program to meet its obligations to the Treasury,

I look forward to continuing to work with the Committee, our NFIP WYO companies, agent groups, and other partners to not only complete implementation of the FIRA04, but also implement future changes to the NFIP.

I would be pleased to answer any questions Committee Members may have.

NATIONAL FLOOD INSURANCE PROGRAM
Estimate of Ultimate Paid Losses from Hurricane Katrina

	Total PIF	Total Coverage	Assumed Frequency	Estimated # Claims	Assumed Severity	Estimated \$ Paid
Counties most impacted by Katrina						
Alabama						
Baldwin County	20,423	3,185,594,800	30.0%	6,127	\$ 60,000	\$ 367,620,000
Mobile County	6,877	1,082,665,900	30.0%	2,063	\$ 60,000	\$ 123,780,000
Mississippi						
Hancock County	5,462	739,082,600	85.0%	4,643	\$ 120,000	\$ 557,160,000
Harrison County	10,218	1,569,645,100	85.0%	8,685	\$ 135,000	\$ 1,172,475,000
Jackson County	5,913	890,349,100	85.0%	5,026	\$ 135,000	\$ 678,510,000
Louisiana						
Jefferson Parish	110,258	17,231,143,900	45.0%	49,616	\$ 75,000	\$ 3,721,200,000
Lafayette Parish	9,180	1,289,897,500	37.5%	3,443	\$ 75,000	\$ 258,225,000
Lafourche Parish	9,334	1,070,954,700	37.5%	3,500	\$ 75,000	\$ 262,500,000
Orleans Parish	85,771	12,699,150,500	80.0%	68,617	\$ 120,000	\$ 8,234,040,000
Plaquemines Parish	5,099	790,362,800	70.0%	3,569	\$ 120,000	\$ 428,280,000
St. Bernard Parish	15,823	2,185,079,000	70.0%	11,076	\$ 120,000	\$ 1,329,120,000
St. Tammany Parish	37,286	7,191,114,100	37.5%	13,982	\$ 75,000	\$ 1,048,650,000
Florida						
South FL Counties	910,933	159,150,128,000	1.0%	9,109	\$ 22,500	\$ 204,952,500
Escambia County	14,681	2,750,764,500	7.5%	1,101	\$ 50,000	\$ 55,050,000
Okaloosa County	18,085	3,092,233,600	2.5%	452	\$ 35,000	\$ 15,820,000
Santa Rosa County	8,183	1,930,472,900	5.0%	409	\$ 40,000	\$ 16,360,000
Counties with Low to Moderate Flooding						
	114,822	16,722,385,800	10.0%	11,482	\$ 20,000	\$ 229,640,000
Katrina - Building and Contents Losses				202,900	\$ 92,180	\$ 18,703,382,500
Katrina - Provision for ICC¹ Claims						\$ 1,745,775,222
Provision for Loss Adjustment Expenses						\$ 1,595,034,302
TOTAL Liability for Losses and Loss Adjustment Expenses						\$ 22,044,192,024

¹ increased Cost of Compliance coverage

Projection of the Federal Cash Flow from NFIP Claims Payments for Hurricanes Katrina and Rita

Dollars Paid and Presented for LOC Drawdowns by the WYO Companies for Hurricanes Katrina, Rita and Wilma

Month End	% of Ultimate Dollars Paid (\$M)	Total Paid & Presented for LOC Draws (\$M)	Interest on Borrowing (\$M)	Estimated Borrowing Authority (\$M)	
Aug-05	0.0%	\$0		(\$36)	\$0
Sep-05	0.4%	\$90	\$2	(\$128)	\$90
Oct-05	3.9%	\$925		(\$963)	\$925
Nov-05	35.5%	\$8,396		(\$8,435)	\$8,375
12/01 - 12/02	38.3%	\$9,079		(\$9,117)	\$9,054
12/05 - 12/09	47.9%	\$11,342		(\$11,380)	\$11,310
12/12 - 12/16	50.5%	\$11,955		(\$11,994)	\$11,917
12/19 - 12/23	53.7%	\$12,714		(\$12,753)	\$12,661
12/26 - 12/31	57.4%	\$13,587		(\$13,626)	\$13,520
01/02 - 01/06	60.9%	\$14,408		(\$14,446)	\$14,321
01/09 - 01/13	64.3%	\$15,229		(\$15,267)	\$15,123
01/16 - 01/20	67.8%	\$16,053		(\$16,091)	\$15,928
01/23 - 01/27	71.1%	\$16,827		(\$16,865)	\$16,677
01/30 - 01/31	73.8%	\$17,469		(\$17,508)	\$17,310
02/01 - 02/03	75.5%	\$17,883		(\$17,921)	
02/06 - 02/10	77.2%	\$18,267		(\$18,306)	
02/13 - 02/17	78.6%	\$18,597		(\$18,635)	
02/20 - 02/24	79.9%	\$18,926		(\$18,964)	
02/27 - 02/28	81.2%	\$19,226		(\$19,264)	\$18,937
Mar-06	82.1%	\$19,435	\$160	(\$19,633)	\$18,857
Apr-06	85.1%	\$20,154		(\$20,352)	\$19,431
May-06	86.9%	\$20,577		(\$20,775)	\$19,782
Jun-06	87.8%	\$20,791		(\$20,989)	\$19,971
Jul-06	88.8%	\$21,032		(\$21,230)	\$20,164
Aug-06	89.7%	\$21,231		(\$21,430)	\$20,325
Sep-06	90.5%	\$21,431	\$511	(\$22,141)	\$20,486
	0				
Mar-07	96.2%	\$22,768	\$537	(\$24,015)	\$21,819
Sep-07	100.0%	\$23,675	\$589	(\$25,510)	\$22,711

NOTES:

- Dollars shown through January 13 are actual.
Dollars shown for January 16 and forward are estimates.
- In addition to paying for Katrina, Rita and Wilma, the Fund will have premium income and will pay for flood losses from other events. The net effects of this other income and expenses on this exhibit are minor compared to these two hurricanes.
- The bulk of ICC claims payments will be made in FY 2007.

DRAFT: *Not for Public Release*