

**TESTIMONY OF DR. DAVID A. SAMPSON
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**“THE NATIONAL FLOOD INSURANCE PROGRAM:
THE NEED FOR LONG-TERM REAUTHORIZATION AND REFORM”**

**SUBCOMMITTEE ON ECONOMIC POLICY
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
May 9, 2012**

Executive Summary

Good morning Mr. Chairman, Members of the Subcommittee. My name is David Sampson and I am President and Chief Executive Officer of the Property Casualty Insurers Association of America (PCI).

PCI and our members believe that the National Flood Insurance Program (NFIP) is vitally important to our nation and the economy, and we are here today to support your efforts to pass bipartisan legislation in the Senate that includes a long-term reauthorization and meaningful reforms.

PCI is the largest property casualty insurance trade association with more than 1,000 members writing approximately 38 percent of all home, auto and business insurance in the country. PCI members write about 52 percent of all the flood insurance as partners with the NFIP through the Write-Your-Own (WYO) program. PCI also chairs the WYO Flood Insurance Coalition, a group that includes the more than 85 private insurers that actively participate in the WYO Program as well as all the other national property casualty trade associations. Thank you for the opportunity to appear before you today on behalf of PCI and its members.

PCI commends you for holding this important hearing. The NFIP is set to expire on May 31 – the day before the official start to the Atlantic hurricane season – if Congress does not act. More than 5.6 million American homeowners, renters, and businesses are NFIP policyholders and rely on this program to protect their homes and their financial security. They are depending on you to act quickly to avoid another lapse in flood insurance coverage. In addition, the millions of Americans who intend to purchase or refinance homes with financing from federally regulated lenders will not be able to do so if they live in a flood plain and Congress fails to extend the NFIP. Finally, the U.S. government, and ultimately taxpayers, will be forced to pay the tab for the next flood if consumers are unable to purchase insurance due to an expired NFIP.

The NFIP is also deeply in debt and needs long-term structural fiscal reform. If a private insurance company held no surplus and carried \$17.75 billion in debt (on \$4 billion in revenue) for 6 years, state regulators would immediately shut it down and the CEO would be fired. And yet the NFIP is

both statutorily unable to charge adequate rates and often unwilling to raise prices by even the amount they are allowed, despite their massive accumulated debt.

Two PCI studies on flood risk pricing revealed that the NFIP is providing government subsidized flood policies at roughly one-third the private sector comparable premium. A RAND study estimated that FEMA is underpricing policies by 20 to 50 percent, and even the Congressional Budget Office estimates that the NFIP's built-in deficit is at least \$1.3 billion annually, with the Government Accountability Office (GAO) suggesting the true program subsidy is far higher. The subsidies for repetitive loss and high flood-risk properties are even greater, estimated by GAO at 40 to 45 percent of government risk costs, with such explicitly subsidized policies actually growing in number and now representing over 22 percent of all federal flood policies. The NFIP is fiscally unsustainable in its current path and must be reformed.

NFIP Reauthorization

The NFIP should be reauthorized on a long-term basis (e.g., 5 years)

Congressional authorization for the NFIP program has been extended on a short-term basis 12 times since September 30, 2008, with the flood program scheduled to expire again on May 31, 2012. A long-term reauthorization will ensure that there will be no gaps in coverage, which occurred four times in 2010 alone, each lapse longer than the previous with increasing uncertainty and frustration among consumers and providers.

Gaps in flood insurance coverage cause significant disruption in the housing markets. Homebuyers in flood zones with a federally backed mortgage are required to purchase flood coverage before the property can be closed on. According to the National Association of REALTORS, in 2010, more than 40,000 real estate transactions were delayed because of lapses in the NFIP's authorization.

Gaps also cause policyholders and insurers to doubt the continued availability of the product. Each time the program lapses, or is extended for a short term, a cumbersome and expensive series of special bridging transactions is required. Insurers, consumers, and the NFIP must set aside policy purchases, collect funds and advance claims payments. This creates significant costs and bureaucracy for the marketplace and uncertainty for Americans who rely on this important protection. This uncertainty has been one of the reasons that several Write-Your-Own carriers have exited the program.

With the next NFIP expiration deadline scheduled for the day before the upcoming hurricane season, Congress and consumers face a potential economic nightmare in both public and private markets if a major storm occurs during a lapse – something that is so easily preventable.

First and foremost to protect Americans and our economy, a long-term reauthorization of the national flood program is needed.

Reforms

Fixing the Rate Structure

The NFIP heavily subsidizes consumer rates across the board, unlike rates charged in the private sector. High flood-risk properties are particularly and explicitly subsidized, as part of a grandfather clause established at the NFIP's inception in 1968 that was expected to shrink over time but has instead morphed into an ever-growing subsidy. Even while carrying tens of billions of dollars in ongoing debt, the NFIP has allowed these subsidies to grow in recent years as it has struggled to impose updated flood maps. Rate increases during that time have been minimal despite increasing predictions of storm loss by catastrophe modelers. While Write-Your-Own carriers have little direct interest in the NFIP's rates, as taxpayers who help facilitate the program, we encourage Congress to consider phasing out NFIP subsidies over time. Government insurance subsidies can create a moral hazard by encouraging overbuilding and discouraging consumer risk mitigation. This results in greater ultimate costs to taxpayers.

The long-term NFIP reauthorization bill passed by the Senate Banking Committee last year includes reforms raising from 10 to 15 percent the ceiling for annual rate increases that the NFIP can establish. Insurers believe that insurance premiums should reflect the risk of loss, and we support this initial improvement. The bill also increases the minimum deductibles for flood losses to reduce program costs and more appropriately reflect prevailing practices in the private insurance market. Increasing the loss deductible should also improve the NFIP's solvency and allow more resources to be reallocated towards loss mitigation and protecting consumers from financial ruin. PCI also supports congressional proposals to establish an NFIP reserve fund, setting aside a percentage of the potential loss exposure. This would better protect consumers and taxpayers, though it would still be a fraction of the surplus that would be required for private insurers.

Increasing the rates is the first step, but the program must also begin to further offset the significant government subsidy (which FEMA states is 40-45 percent for pre-FIRM properties). The rates need to be closer to true market rates before any meaningful discussion related to the private industry taking on flood risk can take place. PCI estimates that flood insurance premiums would need to double, and in some cases triple, if the private insurance market were to write this business on a primary basis. Proposals to end the NFIP's primary flood underwriting are unrealistic given the current steep subsidies and the recognized unwillingness of many homeowners to purchase coverage in high risk areas and at highly subsidized rates, even when mandated.

Address Mapping Issues

The certification of levees and ongoing flood map modernization has continued to be controversial, particularly for consumers who are now required to purchase flood insurance, often at higher-than-average federal rates, as a result of map revisions. While PCI believes that insurance rates should always appropriately reflect the cost of risk, a phase-in for these purchasers as well as the reestablishment of the Technical Mapping Advisory Council are important measures to ameliorate the impact of these changes for consumers, communities, the states and policyholders. PCI and

members of the Write-Your-Own coalition would ask that our industry be represented on that Council by a representative of a flood insurance servicing carrier (a “Write-Your-Own” company).

PCI encourages the extension of the Flood Insurance Reform Act of 2004 program for Severe Repetitive Loss Properties. These properties account for just one percent of NFIP’s insured properties but are responsible for 25 to 30 percent of claims. It is time to buy-out, or otherwise charge the appropriate premium for these properties that continually flood and are rebuilt time after time.

PCI also supports the inclusion of nationally recognized building codes in the floodplain management criteria. This would require FEMA/NFIP to work with the building code councils to include this information. It would provide for better construction of properties and help minimize damage from a variety of perils, including flood, as well as reduce the number of repetitive loss properties over time.

Address Servicing Issues

The “Write-Your-Own” (WYO) program, established in 1984, has been very successful in increasing consumer participation in the NFIP, but it has also been the subject of legislative discussion over the past few years. There have been issues related to loss settlement, expense reimbursement and participation in the NFIP by WYO insurers.

Following Hurricane Katrina, there were significant issues related to the settlement of wind and water losses. Most of these issues would have been addressed by the application of the NFIP appeals process that was included in the Flood Insurance Reform Act of 2004. Unfortunately, that process was not implemented when Katrina hit, but it is in place now. Thus, the rare occurrences of wind-water disputes are already effectively dealt with by existing reforms and no new reporting requirements (such as providing the NFIP with wind claims information) or other legislation is needed to address these issues.

Questions sometimes also arise about the WYO claims expense reimbursement for insurers. Following Katrina, the NFIP worked with the WYO participating insurers to revise the claims expense reimbursement when significant catastrophes occur. Indeed, the NFIP reduced the amount of the claims expense reimbursement where the number of losses are significant and insurers and the NFIP can benefit from some economies of scale. However, the marketplace has now proven that existing claims reimbursement payments are not overly generous. If they were, the number of insurers willing to participate in the WYO program would not have continued to decline. Thus, to the extent any further changes are proposed, we urge careful consideration of the potential effect on WYO participation.

Eliminate Outdated Commissions

Past Senate bills have included provisions establishing a natural catastrophe commission to examine insurance market conditions following the 2005 hurricanes. PCI suggests that the marketplace, its

regulation, and the sophistication of catastrophe modeling have advanced significantly over the past seven years, eliminating the need for such a commission.

Conclusion

A long-term extension of the flood program with fiscal rate reforms is supported by consumers, insurers, environmental groups, taxpayer groups, the real estate industry, and the overwhelming majority of both parties in Congress. At a time when the American economy is struggling to move forward, housing values are still mired in recession, and hurricane season is rapidly approaching, a fiscally sound long-term reauthorization of the NFIP is absolutely critical before another lapse occurs.

PCI applauds your efforts to encourage the Senate to take up this issue and to pass a long-term reauthorization and reform bill before May 31. PCI stands ready to be of any assistance in this effort.

Thank you.