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Subcommittee on Economic Policy
Committee on Banking, Housing, and Urban Affairs
hearing on
"Implementation of the Biggert-Waters Flood Insurance Act of 2012: One Year After Enactment"

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Good afternoon, Chairman Merkley, Ranking Member Heller, 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 the National Flood Insurance Program (NFIP).

Taxpayers for Common Sense has advocated for reform of the National Flood Insurance Program since our inception 18 years ago. The need to remove the subsidies, shift toward risk-based rates, and develop a reserve fund became even clearer after the devastating hurricane season of 2005 left the program nearly $18 billion in debt to the taxpayer. The point became moot after superstorm Sandy upped the debt load to roughly $25 billion and counting.

Taxpayers for Common Sense appreciates the hard work done by this committee to pass the flood insurance reform bill last summer. While we would have argued for even stiffer medicine, the bill represented a good step forward to make the program more responsible for all Americans. It is important that the reforms proceed as enacted and that any efforts to deal with affordability and map modernization be supplemental and not impede the effort to put the flood insurance program on sounder financial footing. There is an increasing fatigue with the cost of the program among taxpayers.

TCS is allied with SmarterSafer.org, a coalition in favor of promoting public safety through fiscally sound, environmentally responsible approaches to natural catastrophe policy. 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 making NFIP responsible.

Unintended Consequences

It is important to understand how we came to this place: a federal flood insurance program of 5.5 million policies that takes in $3.6 billion in premiums and owes the Treasury roughly $25 billion.

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."[2] The program was to make up for a perceived lack of available private flood insurance. But even at the 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.[3]

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 taxpayer-subsidized federal flood insurance over the last several decades made it financially attractive to develop in 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 did 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.[4] FEMA's average largely discounted catastrophic loss years in the equation, something a private insurer would have to take into account. 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 was further challenged because properties that pre-date a community's involvement in the NFIP or the applicable flood insurance rate map (whichever is later)

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

[2] P.L. 90-448.

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

[4] Hayes, Thomas L. and Neal, D. Andrew. "Actuarial Rate Review," Federal Emergency Management Agency. October 1, 2011. P.5. Available at: http://www.fema.gov/media-library-data/20130726-1809-25045-6893/actuarial_rate_review2011.pdf

charitably enjoyed significantly subsidized rates, paying only 35-45% of their actual full-risk level premium, depending on certain assumptions.[5] While the initial thought may be that because of their vulnerability these pre-FIRM (Flood Insurance Rate Map) properties would diminish over time, the Government Accountability Office estimates that 1,153,193 subsidized policies remain.[6] In 2011, FEMA put the percentage of properties in the NFIP that were receiving explicitly subsidized rates at more than 20%.[7]

Furthermore, properties that experienced repetitive losses have made up a demonstrable and 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 25 to 30 percent of the cost of claims.[8] 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.[9] We need to help these people out – out of harm's way – and at the same time help the taxpayer who is stuck with the tab.

Biggert-Waters and Beyond

The Biggert-Waters Flood Insurance Reform Act of 2012 made many significant changes to the NFIP to help it become less fiscally reckless and to better inform policyholders of their flood risk.

In Biggert-Waters, Congress helped address the long-term sustainability of the NFIP. As a consequence, several types of properties that had received pre-FIRM subsidies would have their rates increased by 25 percent a year until they met the full risk based rate. While this may be financially painful in some cases, the subsidies had served to disincentivize behavior and practices that would reduce risk and in the long-run be good for the individual and good for the country. The properties included:

- Non-primary residences
- Severe repetitive loss property (four or more claims exceeding $5,000)
- Properties that have received flood payments that in aggregate exceed the fair market value of the property
- Business properties

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[5] Congressional Budget Office. "Factors Affecting Actuarial Soundness." November 2009. P. 6. Available at: http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/106xx/doc10620/11-04-floodinsurance.pdf

[6] Government Accountability Office. "Flood Insurance: More Information Needed on Subsidized Policies." July 2013. P. 14. Available at: http://www.gao.gov/products/GAO-13-607.

[7] Hayes and Neal. Supra Note 4 at 22.

[8] Statement of Orice Williams Brown, Director Financial Markets and Community Investment, Government Accountability Office before the Senate Committee on Banking, Housing, and Urban Affairs. P. 7. http://www.gao.gov/new.items/d11670t.pdf

[9] Frank, Thomas. "Huge Losses Put Federal Flood Insurance Program in the Red," USA Today. August 26, 2010. Available at: http://usatoday30.usatoday.com/news/nation/2010-08-25-flood-insurance_N.htm

- Property that since July 6, 2012 has sustained damage exceeding 50 percent of the fair market value; or had substantial improvements that exceed 30 percent of the fair market value of the property
- New or lapsed policies
- Policies where the insured refuses mitigation assistance (including relocation)

It is important to recognize that policyholders are not being denied the ability to purchase flood insurance. This provision of the law simply eliminates the subsidized rates. Furthermore, while it may sound like a lot of affected properties, because pre-FIRM primary residences that maintain coverage are not incuded, 62 percent of policyholders (715,259 policies) with subsidized premiums would be unaffected by these changes. In reality, the biggest shift will be that second homes and businesses that used to claim 38 percent of the subsidized policies will now represent only 1.5 percent of the total.[10]

In addition, when flood maps are updated with any changes that increase rates, all properties will be subject to the new rates that will be phased in at 20 percent a year for five years. This effectively ends the previous grandfathering process where some properties retained the highly subsidized premiums for decades.

Biggert-Waters also included several other reform provisions, including:

- Increased lender penalties from $350 to $2,000 per violation, for failing to enforce mandatory purchase requirements for properties in the Special Flood Hazard Areas (SFHA – the 100 year, or one percent chance or more, floodplain).
- Dictates that FEMA set premium rates in aggregate that would generate enough revenue to offset the true average historical loss year (not discounting catastrophic years like 2005).
- Charge premiums that would generate revenue to create a reserve fund to reduce borrowing from the Treasury. FEMA has adopted a five percent surcharge on all premiums to develop the fund.

Other notable provisions regarded mapping: Biggert-Waters established a Technical Mapping Advisory Council to help FEMA improve accuracy, develop standards, and make recommendations on future conditions mapping to more accurately estimate risk. FEMA must incorporate any recommendations from this Council. There is also a Scientific Resolution Panel to arbitrate community appeals of maps using technical or scientific data.

Accurate Maps Are Critical

The NFIP is driven by maps because geography ultimately determines flood risk. 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. The maps are key to

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[10] Government Accountability Office. Supra Note 6 at 14.

the program's success or failure because they define the nation's flood risk and the policyholder responsibility. They must be up to date, accurate, and based on the best available science to be effective. This is why FEMA's map modernization program is critical to the appropriateness of federal government participation in the program and should not be delayed or side-tracked in any way.

The nation's floodplains are dynamic and fundamentally risky. 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.

Not surprisingly, the map modernization effort has been met with some controversy. In some cases, homeowners are facing steep increases in premiums after years, even decades, of paying the same grandfathered pre-FIRM subsidized rate. While the uproar is understandable, it doesn't change the underlying circumstances or the risk or the need to manage the program responsibly. In some cases property owners that didn't have to purchase flood insurance under existing law now find themselves required to do so; others have been mapped out of the floodplain.

Help Those Who Need It

It may be politically expedient and popular locally to delay map modernization or delay rate increases. But what may make good local 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.

In communities affected by possible rate increases there have been a lot of rumors about enormous rate increases. One insurance agent in Plaquemines Parish, LA estimated that under new maps, his flood insurance rate would go from $633 to $28,000.[11] That would certainly give anyone sticker shock, but it is hard to square that rate with what the data to justify it would mean. The median home sales price in Plaquemines Parish fluctuated in 2012 but it is roughly between $200,000 and $250,000.[12] Considering the maximum amount of flood insurance a homeowner can obtain under NFIP is $250,000 (and an additional $100,000 for contents) that would basically mean that FEMA expects this property to be a total loss every decade. If true, this individual and his property are at incredible risk, in which case delaying the rate increase sends absolutely the wrong signal. Or the possible rate increase is inflated, which seems to be the case in St. Charles Parish, where homeowners had been concerned about new $30,000 rates. However as a recent newspaper story noted, the maximum rate was down to $15,000, although the only actual instances cited in the story are of $2,000 and $7,300.[13] These rates are

[11] Hughes, Siobahn. "Flood Insurance Prices Surge," Wall Street Journal. August 12, 2013. P. A3. Available at: http://online.wsj.com/article/SB10001424127887323446404579008922222799170.html

[12] http://www.city-data.com/county/Plaquemines_Parish-LA.html

[13] Barnett, Kyle. "FEMA Insurance Rates Not As High As Projected, But Still Unaffordable," St. Charles Herald Guide. September 12, 2013. Available at http://www.heraldguide.com/details.php?id=13049

the result of new maps and the ending of grandfathering. The parish has indicated their interest in appealing the maps, which is their right and is an import part of the reformed program. Some technical changes may need to be made to the maps, which is something for FEMA and the Scientific Resolution Panel established by Biggert-Waters to consider. Defining the actuarially accurate rates and associated maps are critical to the long-term viability of a federal flood insurance program. That is, the concern is not a matter of local frustration, but of the long term existence of a fiscally fragile program.

In Congress, there has been a series of efforts to delay map implementation and rate increases. In both the House and Senate reported versions of the Fiscal Year 2014 Department of Homeland Security Appropriations bills there are provisions to deny funds "to implement, carry out, administer, or enforce section 1308(h) of the National Flood Insurance Act." That section deals with premium adjustments that would result from updated maps. Depending on how it is interpreted, this provision could lead to at least a one year delay. Or even worse, by allowing new maps to be finalized but not allowing rates to be adjusted on the implementation dates – subsidized rates being grandfathered again until the next map update years from now. Conversely, this would deny any policyholder who would see their rate decrease in new maps from enjoying that rate reduction.

There is other legislation that would delay map implementation or rate increases through a variety of means.

None of these delay proposals deal with affordability or efficiency issues or recognize the very real challenges facing government participation and continued national support for the National Flood Insurance Program. Furthermore the broad nature of the proposals means that millionaire homeowners get the same break that is being championed on the backs of those less well off. It also means that policyholders who were going to see their rates decrease with the new maps will be forced to continue to pay more. And lastly, because the total premium target, which is set by the average historical loss year, is unchanged by these individual delay proposals, every policy holder will have to pay more premium than they would otherwise to make up for continuing decades old subsidies. This is 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.

While the argument to derail reforms centers on the issue of affordability, the data reveals the flood insurance program subsidies substantially benefit the well off. A GAO analysis found that the NFIP program is particularly generous to those in the top deciles of median household income and home value. The GAO reviewed the distribution of subsidized premiums by median home value and median income. It targeted 351 counties[14] that represented more than 70 percent of the remaining subsidized policies and 41 percent of total primary residence policies.

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[14] GAO selected 351 counties nationwide, this included every county with more than 500 subsidized single unit primary residence policies and five counties in every state with the most remaining subsidized policies for single-unit primary residences.

Its analysis found that more than a quarter of the remaining subsidized policies were in counties in the top decile for both median home value and median home income. Only seven percent of the non-subsidized policies were in those same counties. Furthermore, 43 percent of subsidized policies were in counties in the top decile of median home value and 69 percent were in the top two deciles. Overall, 76 percent of the subsidized and non-subsidized policies were in counties in the top two deciles. The counties in the bottom two deciles had 0.4 percent of the subsidized policies and 0.2 percent of the total policies.

A Responsible Approach

A critical role of a federal flood insurance program is to inform people of their flood risk so they can take steps to financially protect their own investments. Rates provide an important price signal of risk.

If Congress wants to deal with the issue of affordability, there are responsible and well-understood ways to accomplish this. The Wharton Risk Management and Decision Processes Center outlines one strategy. The Association of State Floodplain Managers details another. For Taxpayers for Common Sense, any responsible approach to affordability would be:

Self-contained – the taxpayer should not be asked to take on a further burden to support this program. If an affordability policy is undertaken, a small surcharge should be placed on all flood insurance policies to pre-fund the account.

Targeted – One of the underlying problems of subsidized flood insurance is that the subsidies flow to wealthy vacation beach house owners as well as those of modest means. The affordability measures must be available only on a means-tested basis.

Temporary – This should be a short term program to help policyholders deal with sticker shock. A long-term program will undercut the important risk information provided by the price signals.

Independent – The aid should be vouchers or some other assistance that is outside the NFIP rate structure so that it doesn't undercut the price signals of risk.

Helpful – Obviously aid is helpful, but the funding should allow the policyholder to use it for mitigation as well as rate relief.

Logical – Properties should get premium credit for the level of protection that they currently have, even if the flood protection isn't greater than 100-year protection. Last minute maneuvering stripped a provision from Biggert-Waters that would have allowed this.

Conclusion

The National Flood Insurance Program is a narrow program. There are 5.5 million policies, 3.6 million of which are for primary residences and another 1.7 million for second homes. But there are 132.3 million housing units in the United States.[15] This means that while only 4 percent of

[15] http://quickfacts.census.gov/qfd/states/00000.html

housing units nationwide have flood insurance, those policyholders are roughly $25 billion in debt to American taxpayers.

It took extraordinary amount of effort in Congress to increase the NFIP borrowing authority by $9.7 billion after Superstorm Sandy, and that was to enable the program to pay off claims to policyholders. This demonstrates there is fatigue and impatience with this program that is $25 billion in debt. To delay or derail the reforms enacted a year ago would put this program on perilous footing, fiscally, politically, and existentially.