



Testimony of Steve Ellis
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Senate Banking, Housing and Urban Affairs Committee
hearing on
“Reauthorization of the National Flood Insurance Program”

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Good afternoon, Chairman Dodd, Ranking Member Shelby, members of the committee. 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 reauthorizing the National Flood Insurance Program (NFIP).

Taxpayers for Common Sense has advocated for reform of the National Flood Insurance Program since our inception fifteen 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 \$20 billion the program is in debt to the treasury, all have recognized NFIP is fundamentally flawed and must be reformed. The question is how.

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 American Rivers to Americans for Prosperity.

From the National Association of Mutual Insurance Companies to the National Flood Determination Association.¹ The depth and breadth of the coalition of consumer, taxpayer, environmental and insurance industry groups 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.

Stop Digging

Will Rogers' observation that "if you find yourself in a hole, stop digging" has become a cliché, but it's hard to come up with one more applicable to the flood insurance program.

The National Flood Insurance Program is \$18.8 billion in debt to the taxpayer² and only has annual revenues of \$3.1 billion.³ Even if you exclude interest payments, it would take more than six straight years with no claims to pay the debt back. Obviously, this isn't going to happen. With that in mind, any reauthorization of the National Flood Insurance Program must make significant changes to put it on sounder financial footing, not dig a deeper financial hole with loopholes, new insurance lines, or undercutting the program's ability to charge actuarially sound rates.

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>

Taxpayers are staring into a budgetary abyss with predicted average deficits of \$1 trillion a year over the next ten years;⁴ we cannot afford to bail out the flood insurance program again and again. People need to be informed of their flood risk and take steps to financially protect their own investments.

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.”⁵ 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.⁶

⁴ Congressional Budget Office. “Preliminary Analysis of the President’s Budget Request for FY2011.” March 5, 2010. Available at <http://www.cbo.gov/ftpdocs/112xx/doc11231/frontmatter.shtml>.

⁵ P.L. 90-448.

⁶ 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>

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 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.⁷ 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.

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.⁸ While the initial thought may be that because of their vulnerability these properties wouldn't be long for this world, a recent analysis by *USA Today* found 1.2 million buildings receive these

⁷ Hayes, Thomas L. and Neal, D. Andrew. "Actuarial Rate Review," Federal Emergency Management Agency. October 1, 2010. P.5.

⁸ Congressional Budget Office. Supra Note 3 at 6.

discounts.⁹ FEMA puts the percentage of properties in the NFIP receiving subsidized rates as more than 20%.¹⁰

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.¹¹ 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 \$116,000.¹² 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.

Maps Lead the Way

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. There's a map for that. 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

⁹ 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

¹⁰ Hayes and Neal. Supra Note 6 at 22.

¹¹ Brown. Supra Note 2 at 8.

¹² Frank. Supra Note 8.

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 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.¹³

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 geology 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

¹³ 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

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 some cases it makes sense to purchase flood insurance even if you 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 part of the tab.

I'm not here to say that FEMA and their maps are infallible. However, absent strong scientific evidence of specific inaccuracies, efforts to delay and forestall map revisions must stop.

Legislation doesn't alter geology. But that hasn't prevented various lawmakers from introducing legislation to either roll back or delay mapping changes and commensurate rate increases. The House-passed flood insurance reauthorization bill from this summer would delay mandatory insurance for special flood hazard zones and mandate a five year phase-in of rates. A better way to ease any sticker shock would be to provide for relatively short phase-ins of actuarial rates or other assistance.

Don't Make Matters Worse

Besides the mapping issue there are other efforts that would take a backhoe to NFIP's deep financial hole. One is the addition of wind insurance, which was wisely – and soundly – rebuffed

by the Senate in 2007. It simply doesn't make sense to add a whole new business line to the already challenged flood insurance program. FEMA has no experience in pricing wind insurance, and the flood side has proven challenging enough. Besides, there are existing private wind insurance providers. Part of the whole rationale behind the creation of the NFIP was a lack of private flood insurance providers. I recognize that in the aftermath of Katrina there were concerns that in some cases insurance companies categorized wind claims as flood claims to avoid payouts. That should be investigated and corrected through appropriate mechanisms. But to use those instances to justify a federal wind insurance program is the tail wagging the dog.

Another related area is the effort to create a new national catastrophe reinsurance program for state-run reinsurers. Again, this would represent a significant federal expansion into the insurance markets with little justification. Reinsurance – essentially insurance for insurance companies – is widely available and used to hedge an insurance company's risk. However, some states do not want to pay for the actual risks, but want the federal government to subsidize reinsurance rates as well. The legislation to create this program asserts that the program would charge actuarially sound rates.¹⁴ This makes little sense. If this program's rates were truly actuarially sound, they would exceed the private market's rates because the program would be forced to sell reinsurance to a very narrow pool of high risk states, whereas the private market could distribute the risk worldwide. But, remember, the federal flood insurance rates are supposed to be actuarially sound as well. And we already know what happened there.

Reform the Program

¹⁴ H.R. 2555 "Homeowners Defense Act." Section 303 (g).

Enough about what shouldn't be done, we all know there are big problems, so what should be done to reform the National Flood Insurance Program.

The current model is clearly not sustainable. The subsidies have to be phased out and the program has to move toward actuarial rates. This can be done with a maximum of 20% year rate increase for properties paying non-actuarial rates. This isn't just about putting the program on more solid fiscal footing and protecting taxpayers. This is also about fundamental fairness within the flood insurance program and eliminating the cross subsidies that has a few properties paying full freight and picking up the tab for properties that have enjoyed subsidized premiums for decades.

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.

More than 40 years have passed since the National Flood Insurance Program was created. There have been significant advances in insurance pricing, evaluation of risk, mapping and imagery. NFIP should work with the private sector to identify areas that the private sector can begin providing flood insurance. This shouldn't leave NFIP holding the bag elsewhere and increasing levels of debt, but it is worth examining.

Finally, last Congress this committee produced commendable legislation to reauthorize the flood program. In addition to some of the proposals previously mentioned this legislation mandated insurance in residual risk areas – those in the natural floodplain but protected by a levee, floodwall or a dam. Citizens of New Orleans know all too well that even after a levee is built, the risk remains. The legislation also created a reserve fund for higher than predicted loss years and directed NFIP to charge rates to establish and maintain a balance equal to one percent total potential loss exposure in that fund. These are also important elements of NFIP reform.

Conclusion

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.