

STATEMENT OF
THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA
and
THE NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS
before the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
on
NATIONAL FLOOD INSURANCE REPETITIVE LOSSES
March 25, 2004

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Good afternoon Chairman Shelby, Ranking Member Sarbanes and Members of the Committee. My name is Bill Stiglitz and I am pleased to have the opportunity to give you the views of the Independent Insurance Agents and Brokers of America (IIABA) and the National Association of Professional Insurance Agents (PIA) on the National Flood Insurance Program ("NFIP" or the "Program"). I am an independent insurance agent with Hyland, Block, Hyland Insurance of Louisville, Kentucky, and a member of the Executive Committee of the IIABA.

IIABA is the nation's oldest and largest national trade association of independent insurance agents, and represents a network of more than 300,000 agents and agency employees nationwide. IIABA members are small businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents offer all lines of insurance – property, casualty, life, health, employee benefit plans and retirement products.

PIA, founded in 1931, is a national trade association that represents member insurance agents and their employees in all 50 states, the District of Columbia and Puerto Rico. PIA members sell and service all lines of insurance, specializing in coverage of automobiles, homes and businesses. PIA represents its members' interests in state capitals and in Washington, D.C. to ensure that policymakers understand the perspectives and concerns of insurance agents.

Introduction

Let me begin by stating clearly that IIABA and PIA support the NFIP. NFIP provides an important service to people and places that have been hit by a natural disaster. The private insurance industry has been, and continues to be, almost entirely unwilling to underwrite flood insurance because of the catastrophic nature of these disasters. Therefore, NFIP is virtually the only way for people to protect against the loss of their home or business. Prior to the introduction of the Program in 1968, the Federal Government spent increasing sums of money on disaster assistance to flood victims. Since then, NFIP has saved disaster assistance money and provided a more reliable system of payments for people whose properties have suffered flood damage. It is my understanding that since 1986, no taxpayer money has been used to support the NFIP, rather the NFIP has been able to support itself using the funds from the premiums it collects every year. We want the Program to continue and we hope it will get stronger.

Our members -- independent insurance agents and brokers -- play a vital role in the delivery system for flood insurance. The NFIP has about three and one-half million policies in force with over \$370 billion in coverage. The majority of these policies are sold by the more than 110,000 insurance agents participating in NFIP's "Write Your Own" program. This system operates well and this aspect of NFIP does not need revision. In fact, IIABA and PIA are greatly concerned about FEMA efforts to change the WYO program as it applies to insurance agents. I will address that issue briefly at the close of my remarks.

It is clear, however, that reforms of the NFIP are necessary to address operating losses and make the NFIP actuarially sound. The premium structure is not sufficient to allow the Program to build up reserves to cover long-term expected losses. According to the General Accounting Office, multiple loss properties (defined as those with two or more losses over \$1,000 each in a 10-year period) account for about \$200 million in claims per year and about 36% of all claims paid on a historical basis.

What I would like to do this afternoon is explain the five principles that IIABA and PIA believe must animate any NFIP reform efforts to both improve the Program and avoid any unintended negative effects of reform:

- Strengthen NFIP building regulations
- Increase compliance with the mandatory purchase requirement
- Provide additional resources for flood loss mitigation efforts
- Stop abuse of the Program through multiple claims
- Require mandatory disclosures of flood information

1. Strengthen NFIP Building Regulations

The first principle that we believe should be part of any reform of the NFIP is strengthened NFIP building regulations. The building regulations help communities better manage their floodplains in two ways. First, the regulations require communities to ensure that any new construction in floodplains includes safeguards against flood damage such as building new homes above the flood elevation on pilings. Second, the regulations require that any substantial improvements made to existing buildings in the floodplain incorporate safeguards similar to those required for new construction.

Experience with the Program demonstrates that the building regulations work. The majority of flood losses are caused by damage to older homes. In fact, only four percent of repetitive loss properties were built after 1974. In 1999, the Federal Insurance Administration estimated that the Program's construction standards were saving \$1 billion per year. Structures that are built to the Program's standards are three and one-half to four times less likely to suffer flood losses. In addition, the damages to structures built to these standards are 40% less per claim than the damages to older structures.

For example a client of mine with a home on the Ohio River suffered a total loss of \$250,000 in the flood of 1997. In order to rebuild he was required to raise his home above the hundred year flood plain and comply with all lower level standards set by the NFIP. My client now has a magnificent home in total compliance with NFIP requirements and is paying a reasonable premium to continue his flood coverage.

In light of this success, building requirements should be tightened to ensure that properties are built to minimize potential flood damage and to discourage unwise construction in flood plains.

2. Increase Compliance with the Mandatory Purchase Requirement

NFIP would receive additional premiums and improve its financial condition if there were a better rate of compliance with the mandatory flood insurance purchase requirement. In 1973, the purchase of flood insurance became mandatory for any property in a floodplain having a one percent or greater chance of flood occurrence in a given year. The purchase requirement takes effect when a loan is made, increased, extended or renewed on the property. The Federal Emergency Management Agency ("FEMA") has found that fewer than twenty five percent of buildings in areas covered by the mandatory purchase requirement are actually covered by flood insurance. And compliance rates vary dramatically. Based on past disasters, coverage has ranged from less than ten percent to seventy five percent of eligible properties. In fact I have seen that many insured's do not renew their mandatory coverage after the first year due to the cost of the policy and the lack of an enforcement mechanism on the part of lenders.

Sanctions for and enforcement of the mandatory purchase requirement need to be improved so that the Program can collect additional premium to help balance its books, and fund the payment of future losses with a reduced likelihood of having to borrow from the federal treasury.

3. NFIP Should Have Additional Resources for Mitigation

NFIP should take action to prevent future losses. There are two basic ways to do this. The first is through buying the homes and businesses of property owners in the most flood-prone areas so that those individuals can move out of the floodplain. The second is through providing grant funds to owners of existing properties so that they can make improvements (such as raising their structures) that decrease the risk of flood loss. These preventative measures will decrease the number of repetitive claims and save the Program money.

Repetitive loss properties are clearly a drain on the financial resources of the NFIP. In fact, one-quarter of one percent of the properties in the Program are responsible for 10 percent of the losses. Multiple loss properties account for \$200 million per year in claims. As of 1999, GAO reported that the cost of multiple claims had reached \$2 billion over the life of the NFIP. GAO also noted that about 40,000 properties that had made multiple claims were still insured by the Program. Reduction in the number of repetitive loss properties, which would save the

Program millions of dollars, can be accomplished through grants to buy-out property owners or to modify structures to come into compliance with NFIP standards.

A perfect example of the proper use of mitigation funds is the town of English, Indiana. Formerly located on the Blue River, a tributary of the Ohio River, this town was continually inundated by flood waters. Finally, after devastating losses in the early 1990's this small city was moved in it's entirety to higher ground. The citizens of English now enjoy a very nice new town as well as the recreational land along the river which is available for public use.

Buy-outs allow residents to relocate outside the floodplain and prevent future losses. Of course, we must be sensitive to the needs of residents when using buy-outs. Many residents bought their homes before we had full information about the floodplains. The value of many of these homes also may not be sufficient to allow homeowners to relocate to a comparable home. We should avoid creating a new problem by pushing residents out of their homes without sufficient resources to relocate.

As long as the Program is sensitive to the potential dangers, buy-outs can be beneficial tools to improve the financial state of the NFIP. Former FEMA Director James Lee Witt has estimated that there will be a \$2 return on every \$1 spent on buy-outs of repetitive loss properties. That is an impressive return on investment that we should maximize by putting more money into the Program for buy-outs. Past efforts have proved that mitigation works. Damage to towns along the Mississippi River following the 1993 floods were huge -- \$67 million in Wisconsin, \$251 million in Iowa and \$253 million in Illinois. Last year's flood carried about as much water in some areas as in 1993, but, according to the Washington Post, damage estimates in those three States was only \$30 million total. Overall damage from the 1993 flood was more than \$10 billion, but last year was a fraction of that. While some of those savings are attributable to differences in the floods, a lot of it is because people and towns were bought out and moved.

NFIP also should have additional resources for structural modification of properties to prevent losses. Many residents do not want to move and should not be forced to do so. Experience with the NFIP building standards has shown that many owners can elevate their homes or businesses and effectively reduce flood risks. In some cases, modifying the current property is less expensive and equally (or almost as) effective as a buy-out. And this option can help preserve communities to the fullest extent possible. NFIP needs the authority and resources to help property owners improve their properties before the Program suffers additional losses.

4. Stop Abuse of the Program Through Multiple Claims

We need to do more to stop the abuses of the Program. Some individuals have bought in flood zones in order to take advantage of repeat payments from the NFIP. While the people in this category are a small minority of all property owners, they are an expensive minority. There must be some mechanism to either remove these individuals from the Program or make them pay the full, unsubsidized premium based on sound actuarial standards. This approach would be similar to the limitations put on the crop insurance program in which farmers who file numerous, repetitive claims again are put in a special "high risk, non-classified" system with increased rates

and less than full guarantees. Simply reducing abuse of the system will be an important boost to the financial soundness of NFIP.

We also need to recognize that not all repeat claimants are abusing the system. The majority of these people are the victims of natural disasters and bought their homes or businesses without any desire at all to make a claim for flood damage. These are difficult events in people's lives and they should not be punished for them. Many bought without full knowledge of the flood risk to their property and many more do not have the resources to elevate their properties or move. And many of these individuals cannot sell their homes for a reasonable price because they have suffered repeat flood damage -- these folks are stuck in the Program through no fault of their own. They need to be given mitigation options to enable them to escape this nightmarish cycle.

5. Require Mandatory Disclosures of Flood Information

One of the best ways to avoid future problems with the NFIP is to give people information about flood risks. As I said before, many people originally bought their properties without knowledge of the risk of flood. Reform of the NFIP needs to include mandatory disclosures of the flood history of the property so that buyers can make an informed choice in their purchases and they can properly value the home. To make mandatory disclosure effective, we should create an accessible electronic database of flood losses. Disclosure of flood information will help ensure that when a tragedy strikes in the future NFIP does not have to pay for an artificially overvalued property. The disclosure also should bring more people into the Program by giving them the information about their risks.

Finally, IIABA and PIA support the provision of the House-passed bill, H.R. 253, that lengthens the Program reauthorization period from one year to five years. In 2002, Congress adjourned without reauthorizing the NFIP program. This put the program in limbo, and left the industry and more importantly consumers not knowing when or if the Program would be reauthorized and wondering how they should proceed in the meantime. Thankfully, Congress reacted swiftly and passed a reauthorization bill the first week they returned from recess. Those two weeks of uncertainty, however, caused a great deal of panic in the market and had the potential to freeze the entire real estate market because consumers need flood insurance to be able to close on a mortgage. We strongly support the provisions in H.R. 253 that change the reauthorization period to five years and change the expiration day from the end of the year to another time, as to avoid having the program expire at the same time as Congress is adjourned.

Proposed FEMA Regulations Would Harm Agents and NFIP

Before I conclude, I would like to address a pressing issue that greatly concerns agents who sell and service policies under the Program. As I mentioned at the beginning of my testimony, the Federal Emergency Management Agency (FEMA) has proposed a rule that would harm the position of insurance agents participating in the WYO program and, ultimately, be detrimental to NFIP. The proposed rule, published in the Federal Register on October 14, 2003, would amend the Federal Insurance Administration, Financial Assistance/Subsidy Arrangement.

Paragraph 61.5(f) of the FEMA proposed rule would change current standard practice by designating independent property and casualty agents as “agents” of insureds, not agents of private Write-Your-Own insurers, for the purposes of selling and servicing NFIP policies. Currently, the status of an insurance producer as an agent or broker is a contractual issue determined by the producer and insurer.

The regulatory intervention by FEMA into private contractual relationships between insurers and their agents is a sea change in the way NFIP has functioned since 1983 when private insurers were brought into the program and, more broadly, in the relationship between insurers and their agents. The contractual relationship between the insurance producer and insurance company is the defining element in the determination of the status of a producer as “agent” as opposed to “broker.” FEMA’s proposed rule, by dictating that an agent is, essentially, a broker for purposes of NFIP, undermines the agent’s ability to establish such a contractual relationship and, therefore, alters the rights and responsibilities provided for in such contracts.

It is currently standard practice to include cross-indemnification provisions in agency contracts. Thus, agents are required to indemnify insurers in instances where the carrier is held liable for an agent mistake. Similarly, companies are required to indemnify agents for company mistakes. By restructuring the agent-company relationship, FEMA’s proposed rule would effectively do away with agency agreements, including these cross-indemnification provisions. In essence, this change would shield private insurers from liability for their own errors, leaving agents fully responsible for errors which may not be their fault. This will increase the liability exposure of agents and exacerbate the already-difficult task of securing errors and omissions coverage for their businesses. Loss of such coverage could force agents to drop out of NFIP or leave the insurance business entirely.

Finally, the FEMA proposed rule’s effective elimination of agents from NFIP would violate the National Flood Insurance Act. It has been clear since Congress passed the Act that the law and rules promulgated thereunder define the relationships between the federal government and the private parties with which the government deals directly under NFIP. To date, however, the Act and rules have not attempted to define the relationships of private parties with each other. The proposed rule is the first time FEMA has attempted to interfere with private parties in this manner. Although we recognize that FEMA can and does define its relationship with agents that sell and service policies for FEMA directly, there is no statutory or regulatory authority for interfering in the relationship between agents and the WYO insurers for whom they are selling flood coverage.

For these reasons, we urge you to take action to prevent FEMA from adopting the proposed rule, which FEMA intends to make effective May 1 of this year.

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Thank you for giving me the opportunity to express the views of the Nation’s insurance agents on this important Program. The IIABA and PIA look forward to working with the Committee on this issue and I will be happy to take any questions you may have for me.