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FEDERAL EMERGENCY MANAGEMENT AGENCY

Oversight and Management of the National Flood Insurance Program

Statement of William O. Jenkins, Jr., Director, Homeland Security and Justice Issues

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FEDERAL EMERGENCY MANAGEMENT AGENCY

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Highlights

Highlights of GAO-06-183T, a testimony before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, U.S. House of Representatives

Why GAO Did This Study

The disastrous hurricanes that have struck the Gulf Coast and Eastern seaboard in recent years—including Katrina, Rita, Ivan, and Isabel—have focused attention on federal flood management efforts. The National Flood Insurance Program (NFIP), established in 1968, provides property owners with some insurance coverage for flood damage. The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security is responsible for managing the NFIP.

GAO issued a report earlier this week that was mandated by the Flood Insurance Reform Act of 2004. This testimony discusses findings and recommendations from that report and information from past GAO work. Specifically, the testimony discusses (1) the statutory and regulatory limitations on coverage for homeowners under the NFIP; (2) FEMA's role in monitoring and overseeing the NFIP; (3) the status of FEMA's implementation of provisions of the Flood Insurance Reform Act of 2004. It also offers observations on broader issues facing the NFIP including its financial structure and updating flood maps.

What GAO Recommends

GAO recommended that FEMA use a statistically valid method to select claims for review and establish milestones for meeting provisions of the Flood Insurance Reform Act. FEMA expressed concerns about findings related to its management.

www.gao.gov/cgi-bin/getrpt?GAO-06-183T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William O. Jenkins, Jr. at (202) 512-8777 or jenkinswo@gao.gov.

What GAO Found

The amount of insurance coverage available to homeowners under the NFIP is limited by requirements set forth in statute and FEMA's implementing regulations, which include FEMA's standard flood insurance policy. As a result of these limitations, insurance payments to claimants for flood damage may not cover all of the costs of repairing or replacing flood-damaged property. For example, homes that could sustain more than $250,000 in damage cannot be insured to their full replacement cost, thus limiting claims to this statutory ceiling. In addition, NFIP policies cover only direct physical loss by or from flood. Therefore, losses resulting primarily from a preexisting structural weakness in a home, or losses resulting from events other than flood such as windstorms, are not covered by NFIP policies.

To meet its monitoring and oversight responsibilities, FEMA is to conduct periodic operational reviews of the 95 private insurance companies that participate in the NFIP, and FEMA's program contractor is to check the accuracy of claims settlements by doing quality assurance reinspections of a sample of claims adjustments for every flood event. FEMA did not use a statistically valid method for sampling files to be reviewed in these monitoring and oversight activities. As a result, FEMA cannot project the results of these reviews to determine the overall accuracy of claims settled for specific flood events or assess the overall performance of insurance companies and their adjusters in fulfilling responsibilities for the NFIP—actions necessary for FEMA to have reasonable assurance that program objectives are being achieved.

FEMA has not yet fully implemented provisions of the Flood Insurance Reform Act of 2004 requiring the agency to provide policyholders with a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that insurance agents meet minimum education and training requirements. The statutory deadline for implementing these changes was December 30, 2004. Efforts to implement the provisions are under way, but have not yet been completed. FEMA has not developed plans with milestones for assigning accountability and projecting when program improvements will be made, so that improvements are in place to assist victims of future flood events.

As GAO has previously reported, the NFIP, by design, is not actuarially sound. The program does not collect sufficient premium income to build reserves to meet long-term future expected flood losses, in part because Congress authorized subsidized insurance rates to be made available for some properties. FEMA has generally been successful in keeping the NFIP on a sound financial footing, but the catastrophic flooding events of 2004 (involving four major hurricanes) required FEMA, as of August 2005, to borrow $300 million from the U.S. Treasury to help pay an estimated $1.8 billion on flood insurance claims. Following Hurricane Katrina in August 2005, legislation was enacted to increase FEMA's borrowing authority from $1.5 billion to $3.5 billion through fiscal year 2008.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program (NFIP) to discuss the Federal Emergency Management Agency's (FEMA) role in the management and oversight of the NFIP. The NFIP combines property insurance for flood victims, mapping to identify the boundaries of the areas at risk of flooding, and incentives for communities to adopt and enforce floodplain management regulations and building standards to reduce future flood damage. The effective integration of all three of these elements are needed for the NFIP to achieve its goals of:

- providing property flood insurance coverage for a high proportion of property owners who would benefit from such coverage;
- through this insurance coverage reducing taxpayer-funded disaster assistance when flooding strikes, and
- reducing flood damage through flood plain management and the enforcement of building standards (such as elevating structures).

The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security (DHS) is responsible for the oversight and management of the program.[1] Under the program, the federal government assumes the liability for the insurance coverage and sets rates and coverage limitations, among other responsibilities.

Floods are the most common and destructive natural disaster in the United States. According to NFIP statistics, 90 percent of all natural disasters in the United States involve flooding. However, flooding is generally excluded from homeowner policies that typically cover damage from other losses, such as wind, fire, and theft. Because of the catastrophic nature of flooding and the inability to adequately predict flood risks, private insurance companies have largely been unwilling to underwrite and bear the risk of flood insurance.

[1]In March 2003, FEMA and its approximately 2,500 staff became part of the Department of Homeland Security (DHS). Most of FEMA—including its Mitigation Division, which is responsible for administering the NFIP—is now part of the department's Emergency Preparedness and Response Directorate. However, FEMA retained its name and individual identity within the department. Under a reorganization plan proposed by the current Secretary of DHS, the Emergency Preparedness and Response Directorate would be abolished, and FEMA would report directly to the Undersecretary and Secretary of DHS.

Congress established the NFIP pursuant to the National Flood Insurance Act of 1968[2] to provide policyholders with some insurance coverage for flood damage, as an alternative to disaster assistance, and to try to reduce the escalating costs of repairing flood damage. In creating the NFIP, Congress found that a flood insurance program with "large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated."[3] In keeping with this purpose, FEMA has contractual agreements with 95 private insurance company partners to sell policies and adjust and process claims. Flood insurance is available to owners and occupants of insurable property in flood-prone areas. Our work focused on insurance coverage for homeowners. However, coverage is also available for other structures, such as apartment buildings, schools, churches, businesses, cooperative associations, and condominium associations.

As of August 2005, the NFIP was estimated to have approximately 4.6 million policyholders in about 20,000 communities with $828 billion of insurance in force. Since its inception, the program has paid about $14.6 billion in insurance claims, primarily from policyholder premiums that otherwise would have been paid through taxpayer-funded disaster relief or borne by home and business owners themselves. According to FEMA, every $3 in flood insurance claims payments saves about $1 in disaster assistance payments, and the combination of flood plain management and mitigation efforts saves about $1 billion in flood damage each year.

As we finalized the report released this week, the exact extent of the devastation from Hurricanes Katrina and Rita in August and September 2005 was still being assessed; however, the acting director of FEMA's Mitigation Division testified on October 18, 2005 that the NFIP would pay $15 to 25 billion in claims for damage resulting from these two storms. As of October 13, 2005, FEMA had received 192,809 flood insurance claims and the NFIP had paid nearly $1.3 billion to settle 7,664 of these claims. The number of claims filed is more than twice as many as were filed in all of 2004, itself a record year. Clearly, these two disasters will challenge the NFIP with demands the program has never before faced in its more than 35 year history. Already, a record number of flood insurance claims have

[2]The National Flood Insurance Act of 1968, as amended, is codified at 42 U.S.C. 4001 to 4129.

[3]42 U.S.C. 4001(b)(2).

been filed in 2005, and Congress has increased the NFIP's authority to borrow from the United States Treasury from $1.5 billion to $3.5 billion.

GAO is beginning a body of work on the preparation for, response to, and recovery from Hurricanes Katrina and Rita. As GAO moves forward with this work, we will continue to work with this and other congressional committees and the accountability community—federal inspector generals, state and city auditors—regarding the scope of our future work on emergency management issues, including the NFIP. Our goal is to apply our resources and expertise to address long-term concerns, such as those we are discussing today, and to avoid duplicating the work of others. Currently, we have teams in the Gulf Coast states collecting data and observations from hurricane victims and federal, state, local, and private participants in the preparation for, response to, and recovery from these devastating hurricanes, including the flooding they caused.

My testimony today discusses the report we issued on October 18, 2005 that discusses FEMA's management and oversight of the flood insurance program.[4] This report was mandated by the Flood Insurance Reform Act of 2004.[5] It includes recommendations on two pre-Hurricane Katrina flood-insurance related issues that pose a challenge for FEMA. These are (1) improving FEMA's management and oversight of the NFIP and (2) FEMA's implementation of provisions of the Flood Insurance Reform Act of 2004 to provide policyholders a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that flood insurance agents meet minimum NFIP education and training requirements.

The report is based on interviews with FEMA officials, documentation of its monitoring and oversight processes, and our field observations of FEMA's monitoring and oversight activities. In addition, we analyzed the National Flood Insurance Act of 1968, as amended, its legislative history, and FEMA's implementing regulations, and we examined documentation and interviewed officials about FEMA's efforts to comply with provisions of the 2004 Flood Insurance Reform Act. We did our work from December

[4]GAO, *Federal Emergency Management Agency: Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program*, GAO-06-119 (Washington, D.C.: Oct. 18, 2005).

[5]Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, 118 Stat. 712, 727 (2004).

2004 to August 2005 in accordance with generally accepted government auditing standards.

A key characteristic of the NFIP is the extent to which FEMA must rely on others to achieve the program's goals. FEMA's role is principally one of establishing policies and standards that others generally implement on a day-to-day basis and providing financial and management oversight of those who carry out those day-to-day responsibilities. These responsibilities include ensuring that property owners who are required to purchase flood insurance do so, enforcing flood plain management and building regulations, selling and servicing flood insurance policies, and updating and maintaining the nation's flood maps. We have issued reports and testified before this and other congressional committees on these and other issues related to the program.[6] In the report we are releasing today, we note that FEMA faces a challenge in providing effective oversight of the 95 insurance companies and thousands of insurance agents and claims adjusters who are primarily responsible for the day-to-day process of selling and servicing flood insurance policies.

My testimony today addresses four topics:

- insurance coverage available under the NFIP, including coverage limitations;
- FEMA's role in monitoring and oversight of the program;
- FEMA's progress in implementing the requirements of the National Flood Insurance Reform Act of 2004; and
- Some broader challenges facing the program.

[6]See, for example, the following GAO reports and testimonies: *Flood Insurance: Extent of Noncompliance with Purchase Requirements Unknown*, GAO-02-326 (Washington, D.C.: June 21, 2002); *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, GAO-04-401T (Washington, D.C.: March 25, 2004); *Flood Map Modernization: Program Strategy Shows Promise, but Challenges Remain*, GAO-04-117 (Washington, D.C.: March 31, 2004); *Federal Emergency Management Agency: Challenges Facing the National Flood Insurance Program*, GAO-06-174T (Washington, D.C.: Oct. 18, 2005).

Available Insurance Coverage and Limitations Under the NFIP

The amount of insurance coverage available to homeowners under the NFIP is limited by requirements set forth in statute and regulation. As a result of these limitations, insurance payments to claimants for flood damage may not cover all the costs of repairing or replacing flood-damaged property. For example, there is a $250,000 statutory ceiling on the amount of flood insurance homeowners can purchase for the building structure and a $100,000 ceiling on the amount they can purchase for certain personal property. Thus, homes that might sustain more than $250,000 in damage cannot be insured to their full replacement cost.

In addition, to the statutory limitations on coverage amounts, Congress also gave FEMA broad authority to issue regulations establishing “the general terms and conditions of insurability,” [7] including the classes, types, and locations of properties that are eligible for flood insurance; the nature and limits of loss that may be covered, the classification, limitation, and rejection of any risks that FEMA considers advisable; and the amount of appropriate loss deductibles. Pursuant to this delegation of authority, FEMA has issued regulations, including a “Standard Flood Insurance Policy,” that further delineate the scope of coverage.[8] All flood insurance made available under the NFIP is subject to the express terms and conditions of the statute and regulations, including the standard policy.[9] The Federal Insurance Administrator within FEMA is charged with interpreting the scope of coverage under the standard policy.[10]

In addition, NFIP policies cover only direct physical loss by or from flood. Therefore, losses resulting primarily from a preexisting structural weakness in a home or prior water damage, and losses resulting from events other than flood, such as windstorms or or earth movements, are not covered by the NFIP. Personal property is covered, with certain limitations, only if the homeowner has purchased separate NFIP personal property insurance in addition to coverage for the building. Finally, the method of settling losses affects the amount recovered. For example, homes that qualify only for an actual cash value settlement—which

[7] 42 U.S.C. 4013(a).

[8] The insurance coverage regulations appear at 44 C.F.R. Part 61, and the Standard Flood Insurance Policy is an appendix to these regulations, set forth at 44 C.F.C. Part 61, appendix A(1), “Standard Flood Insurance Policy Dwelling Form.”

[9] 44 C.F.R. 61.4.

[10] *Id.* 61.4(b), 61.14.

represents the cost to replace damages property, less the value of physical depreciation—would presumably receive payments that are less than homes that qualify for a replacement cost settlement, which does not deduct for depreciation. Finally, the amount recoverable under the SFIP is limited to the amount that exceeds the applicable deductible.[11] Our report discusses the limitations on coverage and recoverable losses in greater detail.

Monitoring and Oversight of NFIP Identifies Specific Problems, but Does Not Provide Comprehensive Information on Overall Program Performance

About 40 FEMA employees, assisted by about 170 contractor employees, are responsible for managing the NFIP. Management responsibilities include establishing and updating NFIP regulations, administering the National Flood Insurance Fund, analyzing data to actuarially determine flood insurance rates and premiums, and offering training to insurance agents and adjusters. In addition, FEMA and its program contractor are responsible for monitoring and overseeing the quality of the performance of the write-your-own companies to assure that the NFIP is administered properly.

To meet its monitoring and oversight responsibilities, FEMA is to conduct periodic operational reviews of the 95 private insurance companies that participate in the NFIP. In addition, FEMA's program contractor is to check the accuracy of claims settlements by doing quality assurance reinspections of a sample of claims adjustments for every flood event. For operational reviews, FEMA examiners are to do a thorough review of the companies' NFIP underwriting and claims settlement processes and internal controls, including checking a sample of claims and underwriting files to determine, for example, whether a violation of policy has occurred, an incorrect payment has been made, and if files contain all required documentation. Separately, FEMA's program contractor is responsible for conducting quality assurance reinspections of a sample of claims adjustments for specific flood events in order to identify, for example, whether an insurer allowed an uncovered expense, or missed a covered expense in the original adjustment.

Operational reviews of flood insurance companies participating in the NFIP that are conducted by FEMA staff are FEMA's primary internal

[11]SFIP section VI, Deductibles. Applicable deductible amounts are not listed in the SFIP itself, but are shown on the Declarations Page, a computer-generated summary of the information provided by the insured in the insured's application. This page is part of each insured's flood insurance policy.

control mechanism for monitoring, identifying, and resolving problems related to how insurers sell and review NFIP policies and adjust claims. For all aspects of operational reviews, the examiners are to determine whether files are maintained in good order, whether current forms are used and whether staff has a proficient knowledge of requirements and procedures to properly underwrite and process flood claims. Examiners are also to look at internal controls in place at each company. When problems are identified, examiners are to classify the severity of the errors. Each file reviewed is to be classified as satisfactory or unsatisfactory. Unsatisfactory files contain either a critical error (e.g., a violation of policy or an incorrect payment) or three non-critical errors (e.g., violations of procedures that did not delay actions or claims).

Write-your-own companies with error rates of 20 percent or higher of the total number of files reviewed for the specific underwriting or claims operation review would always receive an unsatisfactory designation. In such cases, FEMA requires that the company develop an action plan to correct the problems identified and is to schedule a follow-up review in 6 months to determine whether progress has been made.

The operational reviews and follow-up visits to insurance companies that we analyzed during 2005 followed FEMA's internal control procedures for identifying and resolving specific problems that may occur in individual insurance companies' processes for selling and renewing NFIP policies and adjusting claims. According to information provided by FEMA, the number of operational reviews completed between 2000 and August 2005 were done at a pace that allows for a review of each participating insurance company at least once every 3 years, as FEMA procedures require. In addition, the processes FEMA had in place for operational reviews and quality assurance reinspections of claims adjustments met our internal control standard for monitoring federal programs.

Program Contractor Reinspections of NFIP Claims

In addition to operational reviews done by FEMA staff, FEMA's program contractor conducts quality assurance reinspections of claims for specific flood events. The program contractor employs nine general adjusters who conduct quality assurance reinspections of a sample of open claims for each flood event.[12] Procedures for the general adjusters to follow are

[12]In addition to doing reinspections, these general adjusters are responsible for estimating damage from flood events, coordinating claims adjustment activities at disaster locations, and conducting adjuster training.

outlined in FEMA's Write Your Own Financial Control Plan. According to the general adjusters we interviewed, in addition to preparing written reports of each reinspection, general adjusters discuss the results of the reinspections they perform with officials of write-your-own companies that process the claims. If a general adjuster determines that the insurance company allowed an expense that should not have been covered, the company is to reimburse the NFIP. Conversely, if a general adjuster finds that the private-sector adjuster missed a covered expenses in the original adjustment, the general adjuster is to take steps to provide additional payment to the policyholder.

An instructor at an adjuster refresher training session, while observing that adjusters had performed very well overall during the 2004 hurricane season, cited several errors that he had identified in reinspections of claims, including improper room dimension measurements and improper allocation of costs caused by wind damage (covered by homeowners' policies) versus costs caused by flood damage. In addition, the instructor identified as a problem poor communication with homeowners on the processes followed to inspect the homeowner's property and settle the claim. Overall error rates for write-your-own companies are monitored. Procedures require additional monitoring, training, or other action if error rates exceed 3 percent. According to the general adjusters we interviewed and FEMA's program contractor, qualify assurance reinspections are forwarded from general adjusters to the program contractor where results of reinspections are to be aggregated in a reinspection database as a method of providing for broad-based oversight of the NFIP as its services are delivered by the write-your-own companies, adjusting firms and independent flood adjusters.

Sampling Methods Used to Conduct Operational Reviews and Quality Assurance Reinspections Do Not Provide Management Information On Overall Performance

The process FEMA used to select a sample of claims files for operational reviews and the process its program contractor used to select a sample of adjustments for reinspections were not randomly chosen or statistically representative of all claims. We found that the selection processes used were, instead, based upon judgmental criteria including, among other items, the size and location of loss and complexity of claims. As a result of limitations in the sampling processes, FEMA cannot project the results of these monitoring and oversight activities to determine the overall accuracy of claims settled for specific flood events or assess the overall performance of insurance companies and their adjusters in fulfilling their responsibilities for the NFIP—actions necessary for FEMA to meet our internal control standard that it have reasonable assurance that program objectives are being achieved and that its operations are effective and efficient.

To strengthen and improve FEMA's monitoring and oversight of the NFIP, we are recommending in today's report that FEMA use a methodologically valid approach for sampling files selected for operational reviews and quality assurance claims reinspections.

FEMA Has Not Fully Implemented NFIP Program Changes Mandated by the Flood Insurance Reform Act of 2004

As of September 2005, FEMA had not yet fully implemented provisions of the Flood Insurance Reform Act of 2004. Among other things, the act requires FEMA to provide policyholders a flood insurance claims handbook; to establish a regulatory appeals process for claimants; and to establish minimum education and training requirements for insurance agents who sell NFIP policies.[13] The 6-month statutory deadline for implementing these changes was December 30, 2004.

In September 2005, FEMA posted a flood insurance claims handbook on its Web site. The handbook contains information on anticipating, filing and appealing a claim through an informal appeals process, which FEMA intends to use pending the establishment of a regulatory appeals process. However, because the handbook does not contain information regarding the appeals process that FEMA is statutorily required to establish through regulation, it does not yet meet statutory requirements. With respect to this appeals process, FEMA has not stated how long rulemaking might take to establish the process by regulation, or how the process might work, such as filing requirements, time frames for considering appeals, and the composition of an appeals board. Therefore, it remains unclear how or when FEMA will establish the statutorily required appeals process. With respect to minimum training and education requirements for insurance agents who sell NFIP policies, FEMA published a Federal Register notice on September 1, 2005, which included an outline of training course materials. In the notice, FEMA stated that, rather than establish separate and perhaps duplicative requirements from those that may already be in place in the states, it had chosen to work with the states to implement the NFIP requirements through already established state licensing schemes for insurance agents. The notice did not specify how or when states were to begin implementing the NFIP training and education requirements. Thus, it is too early to tell the extent to which insurance

[13]Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, sections 204, 205, and 207.

agents will meet FEMA's minimum standards. FEMA officials said that, because changes to the program could have broad reaching and significant effects on policyholders and private-sector stakeholders upon whom FEMA relies to implement the program, the agency is taking a measured approach to addressing the changes mandated by Congress. Nonetheless, without plans with milestones for completing its efforts to address the provisions of the act, FEMA cannot hold responsible officials accountable or ensure that statutorily required improvements are in place to assist victims of future flood events.

We are recommending in today's report that FEMA develop documented plans with milestones for implementing requirements of the Flood Insurance Reform Act of 2004 to provide policyholders a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that flood insurance agents meet minimum NFIP education and training requirements.

FEMA did not agree with our recommendations for both its sampling methodology and implementation of the requirements of the Flood Insurance Reform Act of 2004. It noted that its current sampling methodology of selecting a sample based on knowledge of the population to be sampled was more appropriate for identifying problems than the statistically random probability sample we recommended. Although FEMA's current nonprobability sampling strategy may provide an opportunity to focus on particular areas of risk, it does not provide management with the information needed to assess the overall performance of private insurance companies and adjusters participating in the program—information that FEMA needs to have reasonable assurance that program objectives are being achieved.

FEMA also disagreed with our characterization of the extent to which FEMA has met provisions of the Flood Insurance Reform Act of 2004. We believe that our description of those efforts and our recommendations with regard to implementing the Act's provisions are valid. For example, although FEMA commented that it was offering claimants an informal appeals process in its flood insurance claims handbook, it must establish regulations for this process, and those are not yet complete.

Some Broader Issues Facing the NFIP

The NFIP Pays Expenses and Claims with Premiums, but Its Financial Structure Is Not Designed to be Actuarially Sound

To the extent possible, the NFIP is designed to pay operating expenses and flood insurance claims with premiums collected on flood insurance policies rather than with tax dollars. However, as we have reported, the program, by design, is not actuarially sound because Congress authorized subsidized insurance rates to be made available for policies covering some properties to encourage communities to join the program. As a result, the program does not collect sufficient premium income to build reserves to meet the long-term future expected flood losses.[14] FEMA has statutory authority to borrow funds from the Treasury to keep the NFIP solvent.[15]

Until the 2004 hurricane season, FEMA had been generally successful in keeping the NFIP on sound financial footing. It had exercised its authority to borrow from the Treasury three times in the last decade when losses were heavy and repaid all funds with interest. As of August 2005, the program had borrowed $300 million to cover more than $1.8 billion in claims from the major disasters of 2004, including hurricanes Charley, Frances, Ivan, and Jeanne, which hit Florida and other East and Gulf Coast states. The large number of claims arising from Hurricanes Katrina and Rita will require FEMA to borrow heavily from the Treasury, because the NFIP does not have the financial reserves necessary to offset heavy losses in the short-term. Following Hurricane Katrina in August 2005, legislation was enacted that increased FEMA's borrowing authority from $1.5 billion to $3.5 billion through fiscal year 2008.[16] Additional borrowing authority may be needed to pay claims arising from Hurricanes Katrina and Rita.

[14]GAO, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, GAO-01-992T (Washington, D.C.: July 2001).

[15]*See* 42 U.S.C. 4016.

[16]The National Flood Insurance Program Enhanced Borrowing Authority Act of 2005, Pub. L. No. 109-65 (Sept. 20, 2005).

Some Repetitively-Flooded Properties Are Subsidized under Provisions of Authorizing Legislation and Continue to Financially Strain the Program

In reauthorizing the NFIP in 2004, Congress noted that "repetitive-loss properties"—those that had resulted in two or more flood insurance claims payments of $1,000 or more over 10 years—constituted a significant drain on the resources of the NFIP. [17] These repetitive loss properties are problematic not only because of their vulnerability to flooding but also because of the costs of repeatedly repairing flood damages. While these properties make up only about 1 percent of the properties insured under the NFIP, they account for 25 to 30 percent of all claims losses. At the time of our March 2004 report on repetitive loss properties, nearly half of all nationwide repetitive loss property insurance payments had been made in Louisiana, Texas, and Florida. According to a recent Congressional Research Service report, as of December 31, 2004, FEMA had identified 11,706 "severe repetitive loss" properties defined as those with four or more claims or two or three losses that exceeded the insured value of the property.[18] Of these 11,706 properties almost half (49 percent) were in three states—3,208 (27 percent) in Louisiana, 1,573 (13 percent) in Texas, and 1,034 (9 percent) in New Jersey.

As the destruction caused by horrendous 2004 and 2005 hurricanes are a driving force for improving the NFIP today, devastating natural disasters in the 1960s were a primary reason for the national interest in creating a federal flood insurance program. In 1963 and 1964, Hurricane Betsy and other hurricanes caused extensive damage in the South, and, in 1965, heavy flooding occurred on the upper Mississippi River. In studying insurance alternatives to disaster assistance for people suffering property losses in floods, a flood insurance feasibility study found that premium rates in certain flood-prone areas could be extremely high. As a result, the National Flood Insurance Act of 1968, which created the NFIP, mandated that existing buildings in flood-risk areas would receive subsidies on premiums because these structures were built before the flood risk was known and identified on flood insurance rate maps.[19] Owners of structures built in flood-prone areas on or after the effective date of the first flood insurance rate maps in their areas or after December 31, 1974, would have to pay full actuarial rates.[20] Because many repetitive loss properties were

[17] Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, section 2(3),(4), (5), 118 Stat. 712, 713 (2004).

[18] Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem*, RL32972 (Washington, D.C.: June 30, 2005).

[19] 42 U.S.C. 4014(a)(2), 4015(a), (b).

[20] 42 U.S.C. 4014(a)(1), 4015(c).

built before either December 31, 1974 or the effective date of the first flood insurance rate maps in their areas, they were eligible for subsidized premium rates under provisions of the National Flood Insurance Act of 1968.

The provision of subsidized premiums encouraged communities to participate in the NFIP by adopting and agreeing to enforce state and community floodplain management regulations to reduce future flood damage. In April 2005, FEMA estimated that floodplain management regulations enforced by communities participating in the NFIP have prevented over $1.1 billion annually in flood damage. However, some of the properties that had received the initial rate subsidy are still in existence and subject to repetitive flood losses, thus placing a financial strain on the NFIP.

For over a decade, FEMA has pursued a variety of strategies to reduce the number of repetitive loss properties in the NFIP. In a 2004 testimony, we noted that congressional proposals have been made to phase out coverage or begin charging full and actuarially based rates for repetitive loss property owners who refuse to accept FEMA's offer to purchase or mitigate the effect of floods on these buildings.[21] The 2004 Flood Insurance Reform Act created a 5-year pilot program to deal with repetitive-loss properties in the NFIP. In particular, the act authorized FEMA to provide financial assistance to participating states and communities to carry out mitigation activities or to purchase "severe repetitive loss properties."[22] During the pilot program, policyholders who refuse a mitigation or purchase offer that meets program requirements will be required to pay increased premium rates. In particular, the premium rates for these policyholders would increase by 150% following their refusal and another

[21]GAO, *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, GAO-04-401T (Washington, D.C.: Mar. 25, 2004).

[22]Flood Insurance Reform Act of 2004, 118 Stat. 712, 714 (2004). The act defines a "severe repetitive loss property" to mean single-family properties that have received at least $20,000 in flood insurance payments based on 4 or more claims of at least $5,000 each. The act requires FEMA to define in future regulation which multi-family properties constitute "severe repetitive loss properties."

150% following future claims of more than $1,500.[23] However, the rates charged cannot exceed the applicable actuarial rate.[24]

It will be important in future studies of the NFIP to continue to analyze data on progress being made to reduce the inventory of subsidized NFIP repetitive loss properties, how the reduction of this inventory contributes to the financial stability of the program, and whether additional FEMA regulatory steps or congressional actions could contribute to the financial solvency of the NFIP, while meeting commitments made by the authorizing legislation.

Data Inconclusive on Compliance with Requirements for Mandatory Purchase of NFIP Policies

In 1973 and 1994, Congress enacted requirements for mandatory purchase of NFIP policies by some property owners in high risk areas. From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance was voluntary. However, because voluntary participation in the NFIP was low and many flood victims did not have insurance to repair damages from floods in the early 1970s, the 1973 act required the mandatory purchase of flood insurance to cover some structures in special flood hazard areas of communities participating in the program. Homeowners with mortgages from federally-regulated lenders on property in communities identified to be in special flood hazard areas are required to purchase flood insurance on their dwellings for the amount of their outstanding mortgage balance, up to a maximum of $250,000 in coverage for single family homes. The owners of properties with no mortgages or properties with mortgages held by lenders who are not federally regulated were not, and still are not, required to buy flood insurance, even if the properties are in special flood hazard areas—the areas NFIP flood maps identify as having the highest risk of flooding.

FEMA determines flood risk and actuarial ratings on properties through flood insurance rate mapping and other considerations including the elevation of the lowest floor of the building, the type of building, the number of floors, and whether or not the building has a basement, among

[23] *Id.*, , 118 Stat. 712, 717-718 (2004).

[24] DHS' proposed appropriation for fiscal year 2006 includes $40 million to carry out the pilot program. Both houses of Congress passed the bill, and it was presented to the President on October 14, 2005, but, as of October 17, 2005, the President had not signed the legislation. Department of Homeland Security Appropriations Act, 2006, H.R. 2360, 109th Cong., title III (2005).

other factors. FEMA flood maps designate areas for risk of flooding by zones. For example, areas subject to damage by waves and storm surge are in zones with the highest expectation for flood loss.

Between 1973 and 1994, many policyholders continued to find it easy to drop policies, even if the policies were required by lenders. Federal agency lenders and regulators did not appear to strongly enforce the mandatory flood insurance purchase requirements.[25] According to a recent Congressional Research Service study,[26] the Midwest flood of 1993 highlighted this problem and reinforced the idea that reforms were needed to compel lender compliance with the requirements of the 1973 Act. In response, Congress passed the National Flood Insurance Reform Act of 1994. Under the 1994 law, if the property owner failed to get the required coverage, lenders were required to purchase flood insurance on their behalf and then bill the property owners. Lenders became subject to civil monetary penalties for not enforcing the mandatory purchase requirement.

In June 2002, we reported that the extent to which lenders were enforcing the mandatory purchase requirement was unknown. Officials involved with the flood insurance program developed contrasting viewpoints about whether lenders were complying with the flood insurance purchase requirements primarily because the officials used differing types of data to reach their conclusions. Federal bank regulators and lenders based their belief that lenders were generally complying with the NFIP's purchase requirements on regulators' examinations and reviews conducted to monitor and verify lender compliance. In contrast, FEMA officials believed that many lenders frequently were not complying with the requirements, which was an opinion based largely on noncompliance estimates computed from data on mortgages, flood zones, and insurance policies; limited studies on compliance; and anecdotal evidence indicating that insurance was not always in place where required. Neither side, however,

[25]The federal entities for lending regulation are the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Farm Credit Administration.

[26]Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem* (June 30, 2005).

was able to substantiate its differing claims with statistically sound data that provide a nationwide perspective on lender compliance. [27]

Accurate, Updated Flood Maps Are The Foundation of the NFIP

Accurate flood maps that identify the areas at greatest risk of flooding are the foundation of the NFIP. Flood maps must be periodically updated to assess and map changes in the boundaries of floodplains that result from community growth, development, erosion, and other factors that affect the boundaries of areas at risk of flooding. FEMA has embarked on a multi-year effort to update the nation's flood maps at a cost in excess of $1 billion. The maps are principally used by (1) the approximately 20,000 communities participating in the NFIP to adopt and enforce the program's minimum building standards for new construction within the maps' identified flood plains; (2) FEMA to develop accurate flood insurance policy rates based on flood risk, and (3) federal regulated mortgage lenders to identify those property owners who are statutorily required to purchase federal flood insurance. Under the NFIP, property owners whose properties are within the designated "100-year floodplain" and have a mortgage from a federally regulated financial institution are required to purchase flood insurance in an amount equal to their outstanding mortgage balance (up to the statutory ceiling of $250,000).

FEMA expects that by producing more accurate and accessible digital flood maps, the NFIP and the nation will benefit in three ways. First, communities can use more accurate digital maps to reduce flood risk within floodplains by more effectively regulating development through zoning and building standard. Second, accurate digital maps available on the Internet will facilitate the identification of property owners who are statutorily required to obtain or who would be best served by obtaining flood insurance. Third, accurate and precise data will help national, state, and local officials to accurately locate infrastructure and transportation systems (e.g., power plants, sewage plants, railroads, bridges, and ports) to help mitigate and manage risk for multiple hazards, both natural and man-made.

Success in updating the nation's flood maps requires clear standards for map development; the coordinated efforts and shared resources of federal, state, and local governments; and the involvement of key stakeholders

[27] GAO, *Flood Insurance: Extent of Noncompliance with Purchase Requirements is Unknown*, GAO-02-396 (Washington, D.C: June 21, 2002).

who will be expected to use the maps. In developing the new data system to update flood maps across the nation, FEMA's intent is to develop and incorporate flood risk data that are of a level of specificity and accuracy commensurate with communities' relative flood risks. Not every community may need the same level of specificity and detail in its new flood maps. However, it is important that FEMA establish standards for the appropriate data and level of analysis required to develop maps for all communities of a similar risk level. In its November 2004 Multi-Year Flood Hazard Identification Plan, FEMA discussed the varying types of data collection and analysis techniques the agency plans to use to develop flood hazard data in order to relate the level of study and level of risk for each of 3,146 counties.

FEMA has developed targets for resource contribution (in-kind as well as dollars) by its state and local partners in updating the nation's flood maps. At the same time, it has developed plans for reaching out to and including the input of communities and key stakeholders in the development of the new maps. These expanded outreach efforts reflect FEMA's understanding that it is dependent upon others to achieve the benefits of map modernization.

Concluding Observations

The most immediate challenge for the NFIP is processing the flood insurance claims resulting from Hurricanes Katrina and Rita. FEMA reported, as of October 13th, that it had received 192,809 flood insurance claims and had paid nearly $1.3 billion to settle 7,664 of these claims. The number of claims is more than twice as many as were filed in all of 2004, itself a record year. The need for effective communication and consistent and appropriate application of policy provisions will be particularly important in working with anxious policyholders, many of whom have been displaced from their homes.

In the longer term, Congress and the NFIP face a complex challenge in assessing potential changes to the program that would improve its financial stability, increase participation in the program by property owners in areas at risk of flooding, reduce the number of repetitive loss properties in the program, and maintain current and accurate flood plain maps. These issues are complex, interrelated, and are likely to involve trade-offs. For example, increasing premiums to better reflect risk may reduce voluntary participation in the program or encourage those who are required to purchase flood insurance to limit their coverage to the minimum required amount (i.e., the amount of their outstanding mortgage balance). This in turn can increase taxpayer exposure for disaster assistance resulting from flooding. There is no “silver bullet” for improving the current structure and operations of the NFIP. It will require sound data and analysis and the cooperation and participation of many stakeholders.

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be pleased to respond to any questions you and the Committee Members may have.

GAO Contacts and Staff Acknowledgments

Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this statement. For further information about this testimony, please contact Norman Rabkin at (202) 512-8777 or at rabkinn@gao.gov, or William O. Jenkins, Jr. at (202) 512-8757 or at jenkinswo@gao.gov. This statement was prepared under the direction of Christopher Keisling. Key contributors were Amy Bernstein, Christine Davis, Deborah Knorr, Denise McCabe, and Margaret Vo.

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