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Flood Insurance Reform: FEMA's Perspective

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STATEMENT

OF

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BEFORE

THE

HOUSING AND INSURANCE SUBCOMMITTEE

FINANCIAL SERVICES COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.

“Flood Insurance Reform: FEMA’s Perspective”

Submitted

By

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Introduction

Good morning Chairman Duffy, Ranking Member Cleaver, and Members of the Subcommittee. My name is Roy Wright and I am the Deputy Associate Administrator for Insurance and Mitigation – responsible for directing the Federal Emergency Management Agency's (FEMA) risk management, mitigation, and flood insurance programs. Thank you for the opportunity to testify about the National Flood Insurance Program (NFIP), including FEMA's efforts to transform the program in recent years and to request considerations for Congress' reauthorization of the NFIP before it expires in September 2017.

NFIP Background

Flooding is the most frequent and expensive disaster in the United States; 90 percent of natural disasters in the United States involve a flood. Homeowners insurance does not typically include coverage in the event of flooding, and historically flood insurance was not widely available. If it was, it was very expensive. Congress established the NFIP in 1968, which FEMA's Federal Insurance and Mitigation Administration (FIMA) administers.

There are four key elements of the NFIP:

Identifying and Mapping Flood Risk: Working closely with communities, FEMA identifies flood hazards through scientific and engineering methods. FEMA then maps those hazards on a Flood Insurance Rate Map (FIRM). The FIRM is used to help communicate flood risk to communities and the public, and is used for floodplain management and flood insurance requirements.

Floodplain Management: Floodplain management includes actions that communities can take to reduce flood damage to both new and existing buildings and infrastructure. The NFIP plays a role in encouraging communities to adopt and enforce floodplain management regulations including zoning codes, subdivision ordinances, building codes, or special purpose floodplain management ordinances. By law, FEMA can only provide flood insurance to those communities that adopt and enforce floodplain management regulations that meet or exceed minimum NFIP requirements.

NFIP floodplain management requirements are a cost-effective way to reduce the flood risk to new buildings and infrastructure. Internal FEMA studies have found structures built to NFIP standards experience 73 percent less damage than structures not built to these standards; as a result, the standards reduce flood losses by $1.9 billion per year.

Flood Insurance: The NFIP makes flood insurance available for homeowners, renters, and business owners in for 5.1 million policyholders in 22,235 NFIP-participating communities in all 50 states and 6 territories. Seventy-three private insurance companies participate in the NFIP's Write Your Own (WYO) Program, selling and servicing NFIP policies under their own names. FEMA also writes and services some policies outside the WYO Program through NFIP Direct, a vendor that FEMA contracts with and oversees. The NFIP underwrites, and bears the risk, on all NFIP policies, whether sold by private companies or NFIP Direct.

The NFIP functions like other insurance programs, in which policyholder premiums help cover insured losses. Flood insurance helps homeowners recover following a flood. For example, following the flooding in Louisiana in August 2016, insured survivors filed 29,557 claims and, to date, the NFIP has paid more than $2.3 billion in claims. Conversely, FEMA's Individual Assistance grant program has paid more than $758 million to more than 82,000 individuals and households. The average NFIP payment in Louisiana (for the August 2016 flooding) is approximately $86,500 per policyholder while the average individual assistance payment is approximately $9,150. FEMA's Individual Assistance program is not designed to compensate for all losses that a survivor may have experienced. The NFIP is a far more comprehensive program to help homeowners get back on their feet. Homeowners should not rely on potential grant programs to support them following a flood, as they only provide emergency assistance and are not designed to repair or rebuild damaged property.

Incentivizing Risk Reduction through Grants and Premium Discounts: FEMA manages the Flood Mitigation Assistance (FMA) grant program, authorized by the National Flood Insurance Act. This program, designed to reduce or eliminate claims, provides funding to state, local, tribal, and territorial communities for projects that reduce or eliminate long-term risk of flood damage to structures insured under the NFIP. Typical projects may include acquisition of repetitive loss properties, elevation of buildings, and neighborhood-scale flood defense investment. One hundred percent of the funding for this program is paid through premiums on NFIP policies.

The National Institute of Building Sciences' Multi-hazard Mitigation Council estimates that for every dollar FEMA invested in mitigation between 1993 and 2003 (which includes, but is not limited to, FMA programs), society as a whole saved four dollars due to reduced future losses. Mitigation programs save the American public an estimated $3.4 billion dollars annually through a strategic approach to natural hazard risk management, including the value of more stringent building codes.

FEMA also created the NFIP Community Rating System (CRS) in 1990 as a voluntary program for recognizing and encouraging community floodplain management activities that exceed the minimum NFIP standards. Any community in full compliance with the minimum NFIP requirements may apply to join the CRS. More than 1,400 communities around the nation participate in the CRS, accounting for 3.8 million policyholders. Under the CRS, FEMA discounts NFIP policyholders' flood insurance premium rates to reward community actions that meet the three goals of the CRS, which are: (1) reduce flood damage to insurable property; (2) strengthen and support the insurance aspects of the NFIP; and (3) encourage a comprehensive approach to floodplain management. Lower flood insurance rates are just one of the benefits of joining the CRS; CRS floodplain management activities also provide enhanced public safety and reduced damage to property.

The Financial Impacts of Catastrophic Disasters on the NFIP

While Congress appropriates funds for flood mapping, FEMA covers the vast majority of NFIP costs – including operations, floodplain management, risk mapping, and grants – through premiums, fees, and surcharges from the 5.1 million policyholders participating in the program.

Due to the nature of flooding, impacts can vary significantly each year. After 15 years of lower than expected damages, Hurricanes Katrina, Rita, and Wilma hit the nation in 2005. These three catastrophic events resulted in an annual NFIP claims total eight times the size of any prior year in the program's history.

As a mandatory federal program, the NFIP met its commitment to policyholders and paid all claims as outlined in their insurance policies. However, to meet these requirements Congress directed the NFIP to pay for the catastrophic losses through funds borrowed from the U.S. Department of Treasury (Treasury). By the end of the claims process for these events, the NFIP had borrowed $17.5 billion.

In 2012, Hurricane Sandy hit the East Coast and resulted in more than 144,000 NFIP claims. The program paid out an initial $8.4 billion to policyholders. As a result, the NFIP borrowed an additional $6.25 billion from the Treasury to ensure proper payment of all claims. The volume of claims in the aftermath of Hurricane Sandy was much larger than NFIP typically encounters, and policyholders had concerns that FEMA and WYO companies were not handling their claims fairly. FEMA subsequently set up a Sandy Claims Review process to contact all policyholders who had claims and offer them an additional examination of their claim. The NFIP has since paid out an additional $350 million to policyholders, and based on this experience, FEMA took steps to reform key aspects of the program to be more customer-centric.

While there was no single "catastrophic" disaster in 2016, the multiple flooding events in Louisiana, Texas, and several states during Hurricane Matthew resulted in the *third largest* claims payout year in the NFIP's history. Though the NFIP is still processing claims, projected payouts from 2016 flood events total more than $4 billion. In January 2017, the NFIP borrowed an additional $1.6 billion from the Treasury to cover claims, pay interest on the debt, and ensure capacity to pay future claims. Liabilities to the Treasury now total $24.6 billion and, moving forward, require annual interest-only payments of nearly $400 million dollars.

It is important to note that the latest private sector catastrophe modeling demonstrates that none of these events is outside the expected range of NFIP losses. A single storm that results in a loss to the NFIP of the size that occurred in Hurricane Katrina ($16.3 billion) has a 1 to 2 percent chance of occurring in any given year, while a single storm that results in a loss as large as the one that occurred in Hurricane Sandy has a 4 to 5 percent chance of occurring in any given year. NFIP losses experienced during an event such as the August 2016 storm that caused inland flooding in Louisiana has a 4 percent chance of occurring each year. Moving forward, FEMA anticipates having another loss year like those cited above within the next decade.

NFIP Transformation and Lessons Learned

Following Hurricane Sandy, FEMA has taken steps to transform the NFIP customer experience and improve oversight and engagement with WYO companies.

FEMA designed and implemented a new appeals process to improve customer service and transparency to policyholders. The Agency established an Appeals Branch in the Policyholder Services Division, which remains independent from the Product Delivery Division that oversees the claims process.

FEMA also improved its oversight when WYO companies respond to litigation to ensure that policyholders are treated fairly. FEMA established the Office of Chief Counsel WYO Oversight Team. This team works with FEMA's Industry Management Branch to enhance FEMA's oversight of the WYO program and WYO litigation to include oversight of expenses and implementation of a national legal strategy for flood insurance claim litigation with an emphasis on early alternate dispute resolution. Further, FEMA removed the NFIP's Financial Assistance/Subsidy Arrangement with WYO companies from regulation. It is no longer necessary to include a copy of the Arrangement in Title 44 of the Code of Federal Regulations. This process was time-consuming and created a delay to make any administrative updates or changes in regulation. Now, the process is streamlined to improve the ability of FEMA and its industry partners to negotiate operational adjustments and corrections more quickly and efficiently.

The NFIP has also implemented changes to take a more proactive role in disaster readiness and response. During recovery from the Louisiana floods and Hurricane Matthew, FEMA successfully executed components of the new Flood Response Playbook to support insured survivors, including:

- Issuing advance payments to policyholders of up to $10,000 while the NFIP processes their full claims;
- Coordinating with state insurance commissioners and WYO companies to ensure the NFIP meets policyholder needs;
- Deploying FIMA staff to directly support field operations;
- Providing analytical support to assist FEMA operational leadership in making resource decisions; and
- Proactively communicating with WYO insurers and with policyholders through disaster-specific bulletins, webpages, and fact sheets.

In 2016, the NFIP made more than $4 billion claim payments to 83,000 insured survivors. This major year of flood losses highlighted the success of recently-implemented NFIP reforms, as well as the importance of continuing to improve customers' experience with the program. By the end of 2016, FEMA closed 92 percent of the claims from the mid-summer severe storms in Louisiana. In the first 30 days of the incident, FEMA authorized and issued almost $300 million in advance payments to the NFIP policyholders in Louisiana who sustained damages by the flood, providing expedited relief to disaster survivors.

FEMA continues to work on other initiatives to support policyholders, including:

- Simplifying the claims process through improved proof of loss and other forms;
- Modernizing the underwriting process; and
- Redesigning the risk rating system to help customers better understand their flood risk.

Successes from Recent Legislative Reforms

Recognizing the need for NFIP reforms in 2012, Congress acted by passing the Biggert-Waters Flood Insurance Reform Act of 2012 (BW12). This statute served as a key first step to strengthen the NFIP's fiscal soundness by addressing discounted premiums and giving FEMA new tools to manage risk exposure. In March 2014, Congress passed the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA), repealing certain provisions of BW12 and modifying components of the NFIP including flood insurance, flood hazard mapping, grants, and floodplain management.

FEMA has completed implementation of several of key provisions of these laws, including:

- *Establishing the Technical Mapping Advisory Council*: BW12 directed the creation of the Technical Mapping Advisory Council (TMAC). The Council reviews FEMA's mapping program and develops recommendations for improving it. During its assessment, the TMAC found that the mapping program, when applied as designed, results in technically credible flood hazard data in areas where FIRMs are developed or updated, and also provided recommendations to enhance the program in the future. FEMA has established a consistent, integrated, and transparent process to assess and respond to all TMAC recommendations. FEMA has fully implemented 4 of the Council's 22 recommendations outlined in the 2015 report through current operations or ongoing initiatives, and has initiated implementation on an additional 17 recommendations. This year, we began implementation of a TMAC recommendation to develop a national five-year operations plan to help us bridge operations from our current status to where we are headed in the future.
- *Designating an Office of the Flood Insurance Advocate (OFIA):* HFIAA directed FEMA to establish the OFIA in 2015, and the office has experienced significant growth and increased capability since its inception. The OFIA provides assistance to policyholders who are unable to get the support they need after using other existing resources. The OFIA helps coordinate referrals, verify insurance rate information, educate on flood risks and rates, and communicate program changes. Through a new customer relationship management tool, OFIA is able to capture data and provide insights into issues faced by policyholders in order to inform program improvements.
- *Unifying the FMA Grants Programs*: Prior to the passage of BW12, there were three flood grant programs: FMA, Repetitive Flood Claims, and Severe Repetitive Loss. BW12 eliminated the Repetitive Flood Claims and Severe Repetitive Loss programs and added funding for the mitigation of repetitive loss and severe repetitive loss properties under the FMA program. Since unification of the programs, demand for FMA grants has exceeded available funds so FEMA awards grants to those projects that provide the most risk reduction benefit.

- *Establishing a Reserve Fund*: BW12 directed FEMA to set up a reserve fund for meeting the expected future obligations of the NFIP, including payment of claims, claim adjustment expenses, and the repayment of amounts outstanding under any note or other obligation issued by the Administrator. In 2016, the Reserve Fund paid out $1.3 billion in claims to insured survivors. The NFIP has also paid for reinsurance through the Reserve Fund, consistent with its designated purpose for meeting expected future obligations.
- *Managing Risk through Reinsurance*: BW12 gave FEMA the authority to obtain reinsurance from the private reinsurance and capital markets. Reinsurance is an important financial risk management tool used by private insurance companies and public entities to protect themselves from large financial losses by diversifying risk across multiple markets. FEMA executed a one-year agreement, effective January 1, 2017, with a consortium of 25 reinsurers. Under the agreement, reinsurers agreed to indemnify FEMA for flood claims paid during 2017 on an occurrence basis. The layer is structured to cover 26 percent of losses between $4 billion and $8 billion. This agreement transferred a combined total of $1.042 billion of the NFIP's flood risk to the private reinsurance market. This reinsurance placement stands as a first of its kind for a federal program.

FEMA's Core Principles for Reauthorization

Through internal analysis and lessons learned, FEMA offers the following principles that would improve NFIP effectiveness as Congress considers reauthorization.

First, the NFIP reauthorization should be enacted before the September 30, 2017 expiration of the program, and should extend the program for multiple years. The stability of the real estate and mortgage markets depend on an ***on-time, multi-year reauthorization***. All federally-backed mortgage lenders are required to verify that properties in special flood hazard areas (SFHA) have flood insurance policies prior to approving a mortgage. During periods in the past when the NFIP's authorization lapsed, or was only extended for a short period, uncertainty about flood insurance availability impacted property owners' ability to buy and sell homes in high risk flooding areas.

Second, the reauthorization should recognize the need to ***increase flood insurance coverage across the nation***. At a national scale, estimates lead us to believe as little as one third of residential properties in the SFHA have NFIP policies. Yet flooding can happen anywhere. Floods are not wholly contained within SFHAs. Over the past ten years, approximately 20 percent of all NFIP claims come from low to moderate-risk policyholders.

Flood insurance facilitates the ability of a property owner or renter to recover after a flood, whether the insurance is provided by the NFIP or private insurers. ***FEMA recognizes that there is a growing interest by private insurers to offer flood insurance protection.*** FEMA supports this because an insured survivor – regardless of where they purchase their coverage – will recover more quickly and more fully. Two related areas require attention. First, it will take time for the private market to adapt to a market currently primarily served by a public program.

Second, if the private market were to glean only the lower-risk policies, the NFIP would be left with all of the highest-risk policies. This could lower NFIP premium revenue while increasing potential claims payouts. Such actions would leave the program and taxpayers with even more financial risk.

As we look forward to the next several years, a number of opportunities should be explored that could provide for the growth of the private market for flood insurance. Improving the nation's overall flood resiliency will depend on finding an appropriate balance between reducing risk to the taxpayer through a greater private sector role while sustaining a robust and affordable federal program. Among the ideas to explore would be identifying a future point in time by which flood policies for all new construction would be provided by the private market. When coupled with ongoing floodplain management and building code enforcement, these new residential structures would be built to insurable levels of risk for the private market.

In some states, the private flood market already provides excess and surplus coverage as well as "flood riders" on some homeowner's policies. While the private markets are expanding, FEMA is exploring improving the suite of options available for NFIP policies, such as including increased policy limits deck and basement coverage, and various deductible levels. The NFIP would collect additional premiums commensurate with any extra coverage policyholders select. Moreover, by providing coverage options that customers need, the additions could attract new NFIP customers improving the program's financial stability expanding the number of Americans with flood insurance. FEMA also recognizes the unique challenges that farmers may experience when navigating the NFIP's current requirements with regards to agricultural structures. These agricultural needs can be addressed through this re-authorization.

Additionally, the statutory definitions of "repetitive loss" must be brought into alignment so that there is consistency across program elements. Properties that experience multiple losses have an increasingly adverse impact on the financial stability of the program. Congress has previously acknowledged this circumstance, and should explore caps on cumulative losses that well exceed policy limits and the value of the structure. As the program moves forward, NFIP premiums should reflect a property's true risk. We need to move from today's program, which delivers only a final premium which may be lower than a current estimate of the full risk rate, to a program which clearly communicates the full risk rate and any discounts (such as pre-firm subsidy, newly mapped subsidy, or grandfathered rates). Given concerns related to affordability, it may take some time, but the program needs to be on a course to eventually arrive at full risk rates for all policyholders. This includes addressing grandfathered and subsidized rates.

Ultimately, the premium paid for flood insurance must reflect the risk – whether this is done by increasing premiums, reducing risk through mitigation grants, or a combination thereof – the fiscal solvency of the program depends on it. This is central to a ***sound financial framework*** for the NFIP. The NFIP currently carries a debt of $24.6 billion dollars which is serviced through increasingly large interest payments. It is important to note that nearly all of the flood programs mandated by law – programs to reduce risk, the administrative costs of WYO companies, and the payment of interest on the debt – are funded solely through the payment of premiums.

Conclusion

To reiterate, flooding continues to be the most common and costly natural disaster in the United States, with the greatest damage potential of all natural disasters worldwide. Over the past 50 years, the NFIP has helped communities, households, and businesses reduce flood risk, supported flood risk analysis and mapping projects, expanded sound floodplain management practices across the country, and reduced the financial burden to survivors when floods occur. We recognize that the nation faces broad public policy questions around flood insurance affordability, continued development in flood-prone areas, the soundness of the NFIP's financial framework, and greater private sector participation in flood insurance markets.

Through all of this, FEMA's priority is to increase flood insurance coverage so that disaster survivors can recover more quickly and fully after flood events. Through a timely, multi-year reauthorization, Congress would enable FEMA to continue supporting those who take steps to protect their homes and businesses.

Thank you again for affording me the opportunity to speak with you today about this program. I am happy to respond to any questions you may have.