**Testimony of**
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**Before**
**The United States House of Representatives Committee on Financial Services**
**Subcommittee on Housing and Community Opportunity**
**July 17, 2007**

Good morning Chairman Waters, Ranking Member Biggert, and Members of the Subcommittee. I am David Maurstad, Federal Insurance Administrator and Assistant Administrator for the Mitigation Directorate within the Department of Homeland Security's Federal Emergency Management Agency (FEMA). I appreciate the opportunity to appear today before the Subcommittee to discuss H.R. 920 – the Multiple Peril Insurance Act of 2007.

## FEMA's Position on H.R. 920

FEMA is committed to working with the Congress and others to make the NFIP even better, so that when the next storm strikes, more communities will have reduced their vulnerability to flooding, and more citizens will be protected with the financial backstop flood insurance provides.

However, as we look for ways to further strengthen the Program, it is important to remain focused on the Program's mission – helping communities reduce their vulnerability to flooding and providing citizens with affordable flood insurance. H.R. 920 – The Multiple Peril Insurance Act of 2007 – does not foster this mission, and FEMA opposes the bill for several reasons. First, the private marketplace already deals with wind insurance, and wind only affects portions of some states. Government insurance would displace insurance provided by the private market. Second, developing and implementing a multi-peril NFIP would be costly to the government and taxpayers. A federal program would mean that all taxpayers nationwide would subsidize insurance rates for the benefit of a relatively small group of people in high-risk areas. The general taxpayer would pay for actions over which they have no control. Those who can avoid the risk would be passing the cost on to others, creating a system of distortion and inequity. Third, a federal program would undermine economic incentives to mitigate risks because the program would likely distort rates from their actuarial values. Individuals would be encouraged to take on risks that are inappropriate, specifically putting themselves in harm's way because they do not bear the full expected costs of damages incurred. Finally, a new, multi-peril NFIP would displace State initiatives for addressing wind risk through private markets.

I would like to expand upon each of those points:

## The Marketplace Already Offers Windstorm Coverage

Traditionally, the Federal Government has provided insurance only when the marketplace cannot or will not provide coverage that the public must have, which is why the NFIP exists. Wind insurance is available in the States that need it through private property and casualty companies. For the most part, the national property and casualty insurance industry is healthy today. Despite the record $57 billion estimated insured losses incurred as a result of the 2005 hurricane season, industry-wide capital available to cover future losses actually increased during 2005. As a result of lessons learned in 2004 and 2005, insurers have increased their estimates of probable losses from future hurricanes. They have upwardly adjusted the actuarial weights necessary to cover future losses and enhance solvency – which in turn implies higher rates. Although it is true that Florida, North Carolina and parts of Mississippi, Louisiana and Alabama are experiencing difficulties with insurance availability, much of this can be traced to certain State regulatory actions.

First, some States have used State regulation to suppress prices, which has the effect of making insurance unavailable where it may be most needed. The role of State regulation should be to protect consumers from fraud and inadequate risk management by insurance companies, but States sometimes use their regulatory power to control prices. This discourages insurance companies from voluntarily providing insurance in those high-risk areas where unregulated rates would naturally be highest. Insurers need to charge rates that are high enough to allow them to cover expected losses and purchase reinsurance or maintain surplus to cover catastrophic losses. When premiums are not permitted to rise in tandem with loss forecasts, insurers have a very strong incentive to limit their catastrophe risk exposures by withdrawing from high-risk markets and product lines; to do otherwise would jeopardize their financial soundness.

Second, through regulation some States have created State-sponsored insurance programs, which can further drive out private market participants. For example, in Florida, the State-sponsored Citizens Property Insurance Corporation (Citizens) sells property insurance to cover wind storm losses. Citizens was designed to be the insurer of last resort, but is now the largest insurer in the State. Florida's insurance law passed earlier this year makes it easier for Citizens to compete with private insurers by charging competitive rates and by offering a broader array of coverage. Florida's Office of Insurance Regulation reports that Citizens does not have sufficient funds to cover losses from a severe hurricane, so the next major storm could result in significant taxes or assessments on policyholders in order to cover any shortfalls. A private insurance market that was allowed to appropriately price risk would build up the financial resources necessary to remain solvent even when faced with very large claims.

**Developing a Multi-Peril NFIP Would be Costly to the Government and Taxpayers**

The wind risks H.R.920 seeks to address exist in portions of just a few states (primarily the eight Gulf Coast States, due to their catastrophic hurricane risks), while flooding occurs nationwide. Adding wind insurance to a Federal program that addresses a national need would result in a majority of States not exposed to wind risk subsidizing the costs of a minority of States that would benefit from NFIP wind coverage. The general taxpayer would pay for actions over which they have no control. Those who can avoid the risk would be passing the cost on to others, creating a system of distortion and inequity.

Adding windstorm coverage to what is already the Nation's largest single-peril insurance entity would make the NFIP one of the largest insurance underwriters in the world. Such a high-risk, multi-peril insurance program would need reinsurance to protect the U.S. Treasury; consequently, FEMA would have to reconfigure the NFIP's entire financial structure, a complex and costly exercise. Creating and operating a new multi-peril NFIP would substantially increase the cost and complexity of operating a program that is already billions of dollars in debt.

**Distort Rates and Undermine Economic Incentives**

A federal multi-peril program would undermine economic incentives to mitigate risks because the program would likely distort rates from their actuarial values. Individuals would be encouraged to take on risks that are inappropriate, specifically putting themselves in harm's way because they do not bear the full expected costs of damages incurred. Experience with other Federal insurance programs has shown that the Federal Government also is not well positioned to charge adequate premiums to cover the potential risks---this leads to increased costs for all taxpayers.

**A Federal Program would displace State priorities**

A Federal Program would displace State initiatives aimed at ensuring the sustainability of private markets for addressing wind risk. Insurance is a State-regulated industry, and States have taken various approaches to addressing wind risk. As discussed earlier, some States such as Florida have taken recent action to further tighten their pricing regulations and to expand the size of their State windpools. Some States are already beginning to recognize that their well-intentioned attempts to keep insurance prices low have had the unintended consequence of making insurance less available. In Louisiana, the legislature passed proposals that would disband the State's insurance rating commission and allow insurers to set hurricane deductibles on the basis of risk rather than requiring one deductible for all policy holders state-wide. The Governor of South Carolina has called for market-based solutions to insuring coastal homes against storm damages by imposing the costs of those damages directly on those who build in risky areas. Without evaluating any particular State-based approach, the states and the private market participants are best positioned to address wind risk and an appropriate policy response.

**Conclusion**

The 2004 and 2005 hurricane seasons presented the NFIP with challenges on a variety of fronts, and the Program responded by quickly and fairly fulfilling the promises made to NFIP policyholders and communities. Katrina, Rita, and Wilma also presented opportunities to improve, and FEMA is committed to working with Congress and our stakeholders to develop and implement the adjustments needed to make the NFIP even stronger.

However, there is no quick solution that will enable the NFIP to absorb catastrophic events like Katrina, and actions such as amending the Program to include windstorm hazards could prove highly detrimental. Just as important, adding windstorm coverage to the NFIP will not reduce the vulnerability of communities susceptible to wind events; it will crowd out the private sector, increase the costs for U.S. taxpayers and undermine incentives for people to change their behavior. Natural hazards must be addressed by the communities threatened by them, and efforts to reduce these risks should revolve around a comprehensive mitigation strategy. The states and the private sector are best positioned to address the availability and price of insurance in high-risk areas.

I look forward to continuing to work with the Subcommittee, our NFIP insurance companies, agent groups, and other partners to implement future improvements to the National Flood Insurance Program, and I will be happy to answer any questions that the Subcommittee might have. Thank You.