



National Flood
Determination Association

Testimony

Before the
House Committee on Financial Services
Subcommittee on Housing and Community Opportunities
on the
Multiple Peril Insurance Act of 2007
H.R. 920

by
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Chairwoman Waters, Ranking Member Biggert, and the Members of the Subcommittee, I am pleased to have the opportunity to provide testimony on behalf of the National Flood Determination Association (NFDA) in reference to the Multiple Peril Insurance Act of 2007, H.R. 920. I appreciate the concerns of Congressman Taylor and the bill's co-sponsors regarding the adequacy and the viability of the present natural disaster insurance model given the daunting debt obligation facing the National Flood Insurance Program (NFIP), the aftermath of the wind and flood devastation of Hurricanes Rita and Katrina, and the growing concerns related to climate change.

The NFDA is a professional association of companies that work with federally regulated lenders to facilitate compliance with the mandatory purchase requirements under the National Flood Insurance Program and to ensure that improvements located in the Special Flood Hazard Area (SFHA) are covered by flood insurance. Lending institutions provide the compliance mechanism for the NFIP. Flood determination companies assist in compliance by providing guaranteed determinations as to whether or not a property is located in a flood hazard area. Member companies also provide services to insurance companies and agents for rating flood policies under the NFIP, and to other insurance-related entities for risk management purposes. Depending on the marketplace, our industry completes 20 to 30 million flood hazard determinations per year. Annually, the industry responds to as many as 1,250,000 telephone inquiries from lenders, insurance agents and homeowners by answering questions that arise over flood hazard determinations, FEMA's flood maps, and the NFIP itself and its requirements. I have served three different terms as President of the NFDA and currently act as the Policy Advisor and serve on its Board of Directors. In addition to working in the flood determination industry, I have been involved with the NFIP and the property and casualty insurance industry in various executive and administrative capacities for over 20 years.

Two years ago almost to the day, I provided testimony to this Subcommittee on the future of the NFIP and, specifically, about the importance of the flood map modernization initiative of the Federal Emergency Management Agency. Much has changed in these two years. Two years ago the NFIP was reeling from the 2004 group of hurricanes, but was financially in fair shape and optimistic about its future. Who could have guessed that six weeks later following that hearing, the coast of Louisiana, Mississippi, and Alabama would be washed away by 28 foot storm surges, and New Orleans and the surrounding area would fill up like a

bowl causing the worst natural disaster this nation has seen. Hurricanes Katrina, Rita, and Wilma left the NFIP with close to \$20 billion in debt to the federal government.

The NFDA recognizes and appreciates the critical place the NFIP holds bringing together floodplain management, hazard mitigation, mapping, planning and insurance to provide protection against property damage from flooding. We want to see the foundation of the NFIP supported and strengthened by thoughtful action. While we support the motives and the spirit behind the bill, we strongly urge committee members to consider the implications of the creation of a federal multi-peril insurance policy and we suggest that the committee require a study to include a comprehensive assessment of the potential loss exposure due to windstorm, of the potential market for voluntary windstorm insurance, of the effect on the NFIP and the private insurance industry, and of the potential flood compliance implications for federally regulated lenders.

The NFDA's concerns center around the following: (i) the financial and administrative impact that this voluntary windstorm and flood coverage may have on the National Flood Insurance Program; (ii) the potential impact to federally regulated lenders in the form of inconsistent compliance guidelines, gaps in coverage and potential exposure to litigation; and, (iii) the establishment of actuarial rating may not provide sufficient premium income to fund program administration costs and pay flood and windstorm claims in the event of a natural disaster.

Possible Effect on the NFIP

The NFDA suggests that you consider the impact on the NFIP from an administrative and resource perspective. Consider the infrastructure required in order to effectively implement and administer a second program—the windstorm and flood insurance program—within the existing Flood Program. It is not clear under the multi-peril coverage program whether the NFIP will take on this responsibility. If so what could be the extent of the administrative burden to the NFIP? Will FEMA require additional expertise pertaining to underwriting, actuarial science, policy development, program oversight, claims and program management? In the current environment, WYO companies provide a sales channel through independent and captive agent networks, provide agent training, provide policyholder service including issuing policies, and administer claims payments. Would administration be extended to the existing WYO mechanism or through some other mechanism?

Currently, a government contractor maintains the policy database, conducts training and performs the financial and statistical reporting requirements necessary to manage the policies, premiums and claims passed by the WYO Companies to the NFIP. What is the cost in terms of time and money to modify the NFIP policy database to include policy management, rules, program edits, and management reporting? What changes need to be made to the WYO Arrangement and with the government contractor related to management and deployment of this program?

Would the federal multi-peril windstorm and flood program be authorized to borrow from the U.S. Treasury to cover shortfalls? Would premiums from the multi-peril program and the current flood program be pooled?

Additional impact would be felt by stakeholders in the NFIP—communities and consumers. As with the National Flood Insurance Act of 1968, the Multiple Peril Insurance Act proposes a building compliance element which encourages sound construction and design to reduce the potential for damages. However, there is no clarity as to the means of enforcement. Some of the frustrations regarding flood insurance presently surround the requirement for proof of compliance (for example, the Elevation Certificate). The various forms of windstorm hazards that might befall a structure certainly seem to present complex rules for compliance that could result in delays and fees assessed on property owners.

Possible Effect on the Lending Industry

The NFDA works closely with federally regulated lending institutions to assist lenders in fulfilling their obligations under the National Flood Insurance Reform Act of 1994, an amendment to the 1968 Act. Thus, we are familiar with some of the compliance challenges lenders face and are concerned that adoption of this multi-peril coverage program may create new ones.

While it's not clear how and by whom the multi-peril coverage policy will be marketed, it will take time for the lending community to embrace this program. Lenders may be reluctant to accept a voluntary multi-peril policy when flood coverage is required. It is not clear if this program may impact the lenders' compliance obligations under the mandatory purchase guidelines. Flood coverage through the NFIP is fully earned and cancellation is permitted in limited situations. When a lapse in coverage occurs the lender must complete a letter notification cycle to the borrower. When the lender has to place coverage most

likely a gap in coverage will occur leaving them and the homeowner unprotected for a period of time. In certain situations the lender may need to place separate flood and windstorm policies to ensure their collateral is protected. What would be the compliance implications for lenders if a mortgagor whose property is in a Special Flood Hazard Area drops an optional windstorm/flood policy? Lenders will need to have mechanisms put in place to assure purchase of standard NFIP flood insurance in such situations.

The disparity in coverages and coverage limits may place the lender in a precarious position when coverage is mandated to the homeowner by the lender. We urge the Subcommittee to thoroughly explore the implications of introducing a voluntary, higher-limit, multi-peril policy into an existing and established administrative scheme. Specifically, pertaining to the lenders, consider the additional administrative burden, the gaps in coverage, and any potential changes to the mandatory purchase requirement.

Actuarial Rates and Costs

Charging actuarial rates is a sound concept, however, it is no guarantee that there will be sufficient funds to pay all flood-windstorm claims in the event of another catastrophe. It is not known what the market will be for this product, but it is not unreasonable to assume that interest may be highest in coastal, high exposure, regions particularly among property owners who can afford the higher premiums. What is the impact to the program if the number of high-risk, high-value properties disproportionately compose the risk pool? In the event of a catastrophe, how would claims obligations be met if funds are exhausted? Will claims in excess of the ability to pay be backed up by the ability to borrow from the U.S. Treasury?

Summary

The NFDA is grateful to the Subcommittee for holding a hearing on these critical issues. There is a problem when, as noted by the GAO, there is the possibility of, or incentive to, improperly shift wind-related damages to the NFIP to be paid as flood damages in the event of a hurricane. There is a problem in claims adjustment of windstorm and flood losses.

It is important that the Subcommittee recognizes these problems. H.R. 920 offers one response. NFDA is concerned that there are too many unanswered questions

associated with it. We urge the Subcommittee to, at the very least, address the questions raised in this hearing before implementing a new windstorm and flood policy. We also hope that others will come forward with suggestions so that a fuller exploration of means to address the problems can take place.

We are in favor of prudent action which considers the impact on all of the various stakeholder groups—the NFIP, the property & casualty industry, the lending industry, community and state governments, property owners, and taxpayers. We hope the Subcommittee continues the dialogue among these groups to develop a course of action which addresses the problems but does not, inadvertently, create new ones.