MANAGEMENT AND OVERSIGHT OF THE NATIONAL FLOOD INSURANCE PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

OCTOBER 20, 2005

Printed for the use of the Committee on Financial Services

Serial No. 109–60

U.S. GOVERNMENT PRINTING OFFICE

25–373 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
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MANAGEMENT AND OVERSIGHT OF THE NATIONAL FLOOD INSURANCE PROGRAM

Thursday, October 20, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:06 a.m., in Room 2188, Rayburn House Office Building, Hon. Robert Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Harris, Pearce, Neugebauer, Fitzpatrick, Waters, Scott, and Cleaver.

Ex officio present: Representatives Oxley and Frank.

Also present: Davis of Virginia, Kelly, Melancon, and Blumenauer.

Chairman NEY. Today the Subcommittee on Housing and Community Opportunity meets to continue its review and oversight of the National Flood Insurance Program. Specifically, today's hearing will focus on GAO's report on issues related to the NFIP, its management and oversight by the Federal Emergency Management Agency, FEMA, and FEMA's implementation or reforms to the NFIP that were mandated by the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004.

Last year this committee spent considerable time and effort on legislation to reauthorize and reform the National Flood Insurance Program. The legislation includes provisions to strengthen the operational and financial aspect of the NFIP by providing States and local communities with an additional $40 million a year for flood mitigation efforts to try to help with repeatedly flood-prone properties. It allows for increases in flood insurance premiums on properties that refuse Government mitigation offers.

While the Flood Insurance Reform Act addresses a number of procedural problems with the NFIP, additional concerns were raised during the deliberations on the legislation.

Incidental evidence showed that policyholders often did not have a clear understanding of their policies. Insurance claims often did not understand what they were selling or how to process claims correctly. Many policyholders did not know of or understand the appeals process, and many questioned the adequacy of payments in the adjustment system.

The Flood Insurance Reform Act mandated the GAO conduct a study on these issues. The study released this week concluded that improvements are needed to enhance oversight and management of the NFIP.

As evidenced by Hurricanes Katrina and Rita, floods have been and continue to be one of the most destructive and costly natural hazards to our Nation. During this past year there have been three major floods in my district in the State of Ohio. All three of these incidents qualified for Federal relief granted by President's executive order, and recent flooding in January of this year resulted in historic levels in several local dams, and in Tuskares county three communities in the district were forced to evacuate, which displaced 7,000 people in a county out of 70,000.

I was obviously able to witness firsthand the devastation when I toured the damaged properties in Tuskares and Guernsey counties. Of course, we have colleagues who have witnessed unbelievable devastation in their areas of the United States.

Today marks the fourth hearing the Housing subcommittee has held since enacting the Flood Insurance Reform Act. Last week I conducted two productive emergency management summits in Belmont and Athens counties back home. Discussions focused on the devastation of the Gulf Coast and how these recent disasters have amplified many of the shortcomings in the National Flood Insurance Program. It is critical we take the next step forward and review the GAO report and find out why there are so many stumbling blocks to the success of the NFIP.

The National Flood Insurance Program is a valuable tool in addressing the losses incurred throughout this country due to floods. It ensures that businesses and families have access to affordable flood insurance that would not be available on the open market.

Last year's Flood Insurance Reform Act achieved significant reforms to this important Federal program. I look forward to hearing from our witnesses today as we discuss how best to implement the legislation, as well as determine whether new reforms and initiatives are in order to complement the work we accomplished last year.

I want to thank our witnesses this morning for taking the time to share their testimony, their important testimony, with this subcommittee, especially Chairman Richard Baker, Congressman Gene Taylor. Also, I want to thank David Maurstad of FEMA, who should be designated as an honorary member of the Housing subcommittee for his numerous appearances here before this subcommittee. I also believe Congressman Melancon may be—oh, I'm sorry—is here to our right.

I also want to thank our ranking member, Maxine Waters, all her work on this, and also the ranking member of the committee, Barney Frank, and his staff. Mr. Reilly came to Ohio, has had different hearings on disaster issues, along with our staff, Tallman Johnson, Clinton Jones, and Cindy Chetti, who have worked on this issue.

And I will recognize, without objection, the gentleman from Oregon, Mr. Blumenauer, and the gentleman from Louisiana, Mr. Melancon, will be permitted to participate in today's hearing. And, I'm sorry, very important, the gentlewoman Jo Ann Davis from Virginia. The gentleman from Massachusetts?

Mr. FRANK. Thank you, Mr. Chairman. I appreciate the diligence you have been showing in this effort to deal with the terrible events that befell the residents of the Gulf Coast.

As people who follow this closely know, we actually anticipated the need for changes in the Flood Insurance Program. It was interesting afterwards to have people say, "Well, okay with flood insurance, but you've got to do these things," many of which had been done as a result of the initiative of this committee.

The gentleman from Louisiana, with his knowledge of it, had a major role in shaping this bill. There was a genuinely bipartisan effort in the last Congress. Our former colleague, Mr. Bereuter of Nebraska, and our current colleague, Mr. Blumenauer of Oregon, worked together to do this. And we will be talking, obviously, both about what can be done here, but also—and I noted our Senate colleagues raised some questions.

Again, it was bipartisan. It was both the Senator from Kentucky, Mr. Bunning, and the Senator from Maryland, Mr. Sarbanes, who pressed for better implementation of some of the things we put into the bill last year, including mitigation.

We are sometimes accused of just sending out money and the legislative work we did last year clearly refutes that. And in a bipartisan way, we and the initiative to come out of this committee—and the chairman of the full committee was one of those most responsible for it happening—we restructured that program and put into it many of the safeguards, both environmental and fiscal, that people wanted.

I was very pleased when that bill was being pushed that it had strong support from the taxpayer groups concerned about a better use of Government money and the environmental groups. So there are some aspects of that bill that are not being implemented. Obviously, we understand the focus right now on the aftermath of Katrina, but that's only for the last month and a half. And there is I think an obligation on the part of those responsible to explain to us why more hasn't been done to implement last year's bill and to give us more assurance.

Beyond that, I want to express my strong support for the efforts that our colleague from Mississippi, Mr. Taylor, has taken. And New Orleans, obviously, is a picturesque and famous part of American culture celebrated in movies, and books, and song, and has been the focus of a lot of attention, understandably, but it is not the only part of the region that was hit.

Mr. Taylor represents a part of the region in the Gulf of Mississippi that was hit very hard. He has been absolutely tireless from the very first moments in calling attention to that, and working responsibly to try and get some aid for those people he represents, and we are talking particularly about people who don't have vast resources.

And again, as I said, people sort of saw the TV pictures of the victims of this disaster in New Orleans. We have other victims who deserve every bit as much attention, and Mr. Taylor has been reminding all of us of that, and I was particularly pleased to work with him on his legislation that would provide some help for people who did not have flood insurance.

And I think to let people's—to let the situation rest where people of moderate income, low income obviously, but even people of moderate income whose houses have been wiped out, to get no help whatsoever when their houses are wiped out through events over which they had no control is a great mistake.

And I believe that we have the capacity to respond. I think we can respond in ways that do not encourage future irresponsible behavior. There were people who were badly advised. There were flaws in the Federal program. I do not think the moderate income homeowners of the Gulf Coast of Mississippi ought to bear that burden, and we also want to understand that by helping them, we also avert serious damage to our financial system.

One of the things that I most fear, and I know many other members of the committee share this, is a continued move in this country towards larger and larger banks and a threat to the smaller community banks. We need a mix. We don't want to see the smaller banks and the credit unions forced out of business.

If, in fact, the most responsible banker in the world, the most responsible credit union official in the world whose locus was in Mr. Taylor's district or in parts of Louisiana had made home loans that were perfectly reasonable, he or she would now find the situation where the bank's future is threatened, not because of any error anybody made, but because of an entirely unanticipated event.

And if we allow the individuals to go uncompensated, not only do we have serious problems for them as individuals to which I think we should respond, but we get systemic problems. We will see bank failures. We will see credit unions go under that cost the Government some money on the insurance front. But even more negatively, it undermines our ability to keep this network of community banks.

So, the legislation Mr. Taylor has put forward I think is a very responsible way to provide desperately needed help for individuals who have worked hard all their lives, did nothing wrong, and found themselves in this distress, but also, as part of our responsibility to the Banking Committee, averts a further push towards the kind of excessive consolidation of the industry, which is not a good thing.

Thank you, Mr. Chairman.

Chairman NEY. Thank you. Without objection, I have several statements for the record: a statement of the National Association of Professional Insurance Agents, a statement of the Independent Insurance Agents, a statement of Representative Jo Ann Davis, a statement of Steve J. Kanstoroom. Without objection, it will be part of the record.

[The following information can be found on pages 52, 145, 149, 152 in the appendix.]

Any opening—Mr. Pearce, opening statement? Mr. Scott, opening statement?

Mr. SCOTT. Very brief, Mr. Chairman. First, let me thank you for the excellent leadership you are providing on this issue, and I certainly look forward to hearing from Mr. Baker and Mr. Taylor, of Louisiana and Mississippi areas that were hit so impactfully. We have no better twosome in this Congress that can deal with it and help us understand the magnitude of the tragedy because they, indeed, were in the eye of the storm, as were their constituents.

It seems to me we have two issues to consider when reviewing flood disaster responses. The first is to determine if flood maps are updated and accurate and if enough homes are covered by the insurance.

The second issue is whether or not Federal agencies are prepared to work with State and local authorities to plan for and execute a disaster plan. FEMA has estimated that national flood insurance claims for Hurricanes Katrina and Rita could exceed $22 billion. This amount would surpass the total payout since the program began 37 years ago.

Now we have Wilma that is now headed to Florida according to the latest estimates of direction. It could change at any time, however, but Florida seems to be directly in the path, and it is estimated to be one of the most powerful storms ever on record.

It is imperative that flood mapping be quickly updated in all coastal communities while insuring that those homes adjacent to flood plains have adequate protection.

Most of the ninth ward residents in New Orleans were not required to purchase flood insurance since Federal flood maps assume that these neighborhoods would be protected by the levee system. There are concerns that many of these residents will now lose their homes.

I look forward to the hearing. And, hopefully, we can address some very critical questions. For example, should FEMA be independent from the Department of Homeland Security? How would you grade FEMA's ability to work with State and local officials in flood map development? We need to elaborate on the current efforts of the Department of Homeland Security, to work with local communities to plan for disasters and terrorist preparedness.

We need to determine are we finding that other communities are not following through on their preparedness. These are very critical questions for a very critical time in our Nation, and I look forward to this hearing and hearing from this distinguished committee. Thank you, Mr. Chairman.

Chairman NEY. Well, I thank the gentleman. The gentlelady, our ranking member from California?

Ms. WATERS. Thank you very much, Mr. Chairman. I would like to submit my statement for the record and just briefly say that it is not enough to say how frustrated I am with the lack of support and protection for the victims of these hurricanes.

Mr. Chairman, you have held hearings where we have attempted to get at vital information about the National Flood Insurance Program. And I think that on more than one occasion we have been misled.

And it appears that just as FEMA was in chaos following the hurricane, not equipped or able or competent to respond in a timely manner, now we are learning that the National Flood Insurance Program appears to be not what some of us thought it was. And many of the allegations that have been made about adjusters, et cetera, appear to be true.

And so, I am going to let us get on with this hearing today and have some questions to answer later. And I will submit my statement for the record.

Chairman NEY. I want to thank the gentlelady also on her work on this issue.

Mr. Cleaver has no opening statements. Mrs. Davis? The gentlelady is not—Mr. Neugebauer?

Mr. NEUGEBAUER. Well, just briefly, Mr. Chairman, I think this is an important hearing. And one of the things I think that we need to continue to think about is ways that we make this flood insurance program an insurance program that works.

But I think what we do also need to understand is what the limitations to a flood insurance program are. And one of the things that I believe that we are going to have to do is go to a risk-based system where we are in areas where there is a higher risk for the kind of events that we have witnessed in the past few months, that there may have to be a higher premium for that.

Because certainly what we don't want—and we have to have a system where there is participation and not the anticipation that every time one of these events happens, that the Federal Government is going to have to step up and be responsible for the losses that occur. And I think that the perfect system is one that, hopefully, maybe incorporates more in providing a partnership with the Federal Government and the private sector to determine what these risks are, and how to adequately build a premium base that will support those programs.

But obviously, there is much more risk in a river rising in certain areas than there is a hurricane wall that none of us can foresee the surge that might happen during that time. So I look forward to having some important dialogue about this program.

Chairman NEY. The gentleman from Louisiana, do you have an opening statement?

Mr. MELANCON. No. I think anything that I would express would be expressed by Mr. Taylor or Mr. Baker. Thank you, Mr. Chairman.

Chairman NEY. Thank you. The gentleman from Pennsylvania, do you have an opening statement? Thank you.

With that, we will move on. I just wanted to—did want to say a couple of things. The ranking member, I think, was one of the first non-Gulf Members of Congress on the scene in the New Orleans area and in other parts of the Gulf, extensively looking also at the shelter situation down there.

And also, the first hearing we had was requested by the gentlelady, actually, from Virginia, Mrs. Davis, and we appreciate you starting us rolling.

And I am going to move on right away. I want to say one other thing, too, that I don't think the public knows. And I know it wearing another hat, chairman of the House Administration Committee. I just want to give credit to the Members sitting here, the three Members from the Gulf, and the other Members, both sides of the aisle, from the Gulf and their staffs.

When this all happened, we extensively dealt with the Members. If the staff couldn't get a phone call through, they tried 900 more times until it happened. They wanted to make sure they were there for the constituents, the Members and your staff. They did a remarkable job under a very terrible situation to make sure that they were there for your constituents, as you all were. So I credit you for that.

With that, we will start with Mr. Baker, Chairman Baker.

STATEMENT OF HON. RICHARD BAKER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Mr. BAKER. Thank you, Mr. Chairman. I want to express my appreciation to you and the Members for your continuing attention to these difficult subject matters.

As to your responsibility in House Administration, I certainly want to acknowledge the extent to which you and your staff went in trying to facilitate just the simplest of tasks. Just communication was extraordinarily difficult. And your team went well beyond any expectation in trying to assist us in meeting our obligations. And for that, I am grateful.

I think to speak to this issue this morning, I want to start with just a brief historical story to establish my credentials on this matter. My dad is now a retired Methodist preacher. Years ago, served a church in Baton Rouge for 10 years. And when I went to the church—I was 6 when we left—I was 16, so I was affectionately known in the church as Little Richard. That causes some confusion, I'm sure.

[Laughter.]

Mr. BAKER. However, when my dad would meet with individuals after our departure from the church, he ran into a lady, a senior lady, who said, "Well, Reverend, how is Little Richard these days?"

And he gave the usual kinds of explanations about legislature and elected to Congress, and so forth. And when she heard, "He is now a Member of Congress," she dropped her head and said, "Oh, he used to be such a nice young man."

I think the flood insurance program and I enjoy similar regard. And I am speaking here today in defense of the flood insurance program. I would like to establish that when any natural disaster affects any region of the country, the only natural disaster which has a structured program where we collect premium and pay out benefits is the flood insurance program.

Whether earthquake, tornado, mudslide, fire, we simply write checks out of the United States Treasury. Questions have not been asked, "How do we have budget offsets for those expenditures?" We respond because people are in need.

Since 1988, every dollar advanced to pay claims for the National Flood Insurance Program have been repaid with interest, with premiums paid by policyholders.

Now that doesn't mean that the system can't be made better. Two years ago—Mr. Frank made reference to the reforms that were adopted relative to repetitive lost properties. I will admit, Louisiana was one of the contributors to a significant problem. There was one property I know of where there were 21 claims submitted and paid. There is no excuse for that.

The reforms adopted 2 years ago went to great lengths to eliminate abusive and inappropriate practices, and there are still limitations in the program's implementation. But I will say to you, Mr.

Chairman and members, in principle, what the flood insurance program provides is a well structured program that operates as intended with room for improvement. There is no other natural disaster that can lay claim to any such structure.

Therefore, I find the discussion of whether we should have a flood insurance program, that it's abusive or wasteful, frankly, very inappropriate. Mr. Taylor, I know, has a remedy for needs he has identified. I have my own program that I am introducing today that addresses some needs.

Certainly we ought to have a discussion about how we can improve on it. But the idea that this is taxpayer money flowing out the door without accountability is simply not accurate.

Where do we go from here? One of the matters which I think needs to be addressed is the current limitation on the line of credit. As I indicated, if you have a rush of claims and there is no cash in the drawer, you can go borrow money, which is subsidized by the taxpayer—today, up to $2 billion.

As has been mentioned by members earlier, the expected losses to be paid merely for Katrina are approaching—and they, in fact, exceed—$20 billion. There will be a necessity to increase that line of credit for borrowings to pay obligations as they come due.

I think it appropriate when we are addressing the line of credit that we also address the issue of the $250,000 limit. For those not familiar with the aspects of the program, if you choose to buy all of the flood insurance one can attain through this program, the maximum you can get for your structure is $250,000, and $100,000 for contents, for a total of $350,000.

As people on the lakefront of New Orleans are painfully learning, who may live in a $1 million or $2 million or $3 million home, the flood insurance won't buy the lot back after this disaster. And so, it ought to be made available on an actuarial basis where a person can acquire whatever flood insurance they think appropriate for the risk they face.

Enforcement. Louisiana is only second to Florida in the number of policy holders who pay premium. We're about 42, 43 percent, somewhere in that range. I do not understand why financial institutions do not mandatorily force place flood insurance coverage when they issue a loan to an individual.

Let me, for sake of reference, bring to the committee's attention the map dated March 1, 1984, for the principal area known as New Orleans. There is a notation on this map. By the way, all of this is—would be normally—in the flood zone. But it's designated as Flood Zone B. There are a whole host of flood zone designations which relate to the rate you pay, your premium. All zone B areas are protected from the 100 year flood by levee, dike, or other structure, subject to failure or overtopping during larger floods.

March 1, 1984, Mr. Chairman. Why is it that a financial institution extending hundreds of thousands of dollars of credit would not take the fiduciary responsibility to require flood insurance on those properties for which they are extending credit? It makes no sense.

I think we should have a requirement that within a certain number of miles of a coastal zone—from New York, which experienced a hurricane in 1938, to Washington State—the entire coastal area of the United States should be mandatorily required to participate in paying premium to the flood insurance program. That is the only way we can address Members' concerns about repayment of lines of credit extended to meet obligations of Rita, Katrina, and—God help us all—Wilma.

We all know they are going to come. We all know that coastal areas are exposed. Why don't we address it and simply say, "Everybody is in the deal." That's what keeps prices low. That's what keeps taxpayers from being unnecessarily under financial duress. It's logical, defensible. I'm from Louisiana. I live 8 feet above sea level. I can do this. The rest of the Congress should be able to do this.

This past two weekends, we watched as New England unexpectedly suffered extraordinary flooding loss and loss of life. What is not generally described or known, outside the 100-year flood plain—everybody is familiar with the 100-year flood plain. If you're in the 100-year flood plain, everybody says you ought to have insurance. Twenty-five percent of all the claims paid by the National Flood Insurance Program are for properties outside the 100-year flood plain.

Now we can't simply say, "Because you're outside the 100-year flood plain, you have no obligation to protect your property." We need to have better mapping and assessment. We need to have an identification of risk and people obligated to participate in the flood insurance program and assessed a premium in relation to their actuarial rate exposure.

I will introduce today legislation to create a Louisiana Recovery Corporation. The corporation will be empowered to issue debt off budget, subject to approval by the Treasury, to get us out of the recurring necessity to come to this Congress and fight appropriations battles.

We cannot tell you today the cost for our environmental remediation. We cannot estimate the cost to give people the opportunity to move on with life. That information will develop over years as we move forward with our redevelopment effort.

There is no local authority. The State government doesn't have the ability. Fitch, Moody's S&P have all downgraded our ability to issue debt. We're on a negative credit watch. It's only a matter of time before our ability to sell debt obligations in the capital markets will be so impaired it will make no sense. We have to have the Federal Government's ability to borrow.

I understand there is an obligation to each of you and your constituents to be transparent and responsible for the money we spent and, to the best of our ability, repay what we are borrowing from the rest of the generosity of the Nation.

To that end, we should empower this organization to go in and acquire large tracts of land, respecting private property rights. If you want to take a cash settlement and move on, fine. You're going to take a loss. So is the bank. The banks are going to come in for a big hit on this. So are the insurers.

If you want to stay with us, and live through the redevelopment, and have your tract of land back when it's done, fine. We're not going to pay you anything; you're just going to be a partner in redevelopment.

If you would like to have a cash payment and have an option of first right of refusal on the redevelopment of property, that's fine too. We will give you that shot. And if you want to come back and buy at market rate that tract of land, that's fine.

If you don't want to do any of it, if you want to just sit it out on your tract of land where you are today with no help from anybody, that's your choice. You can do that too. Respecting private property rights. There is not going to be bulldozers running wild down the middle of New Orleans taking people's property away from them.

At the same time, in order for a redevelopment to occur, somebody has to be able to provide for levee restoration, environmental remediation, basic infrastructure so we can have large tracts of developable property made available to the market.

Last week of this month, we will have the GSE reform bill on the floor. One of the important assets of that bill is an affordable housing fund. It will make available $500 million to about $1 billion annually of affordable housing money for Katrina/Rita victims.

This redevelopment plan will not be about making rich people richer; it will be about rebuilding Orleans and the surrounding area in a way which is a modern community that affords opportunity for everybody, from subsidized housing, multi-family, to giving those who have good fortune an opportunity to reclaim some of their loss.

Mr. Chairman, I hope you and members of the committee will carefully review the legislation known as the Louisiana Recovery Corporation, and in concert with your ongoing examination of the flood insurance program, in concert with the massive redevelopment requirements that are going to be needed for Mr. Taylor, myself, Mr. Melancon—and I want to get that on the record; it's Melancon—that we are going to be around for a long time asking for a lot. We know it.

We need to be held accountable; we need to be subject to reporting standards. We want to do this the right way.

I thank you, Mr. Chairman.

Chairman NEY. Thank you.

The gentleman from Mississippi.

STATEMENT OF HON. GENE TAYLOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSISSIPPI

Mr. TAYLOR. Mr. Chairman, thank you very much for letting me appear before your committee. And on a private note, as someone from possibly the most affected area by the storm, I want to thank you in your capacity as the chairman of Oversight for allowing me to hire, within the limits of my budget, a couple of extra staffers because of the unprecedented amount of casework that has been generated by this storm. I thought that was incredibly generous on your part, and I think it should be noted by my colleagues.

Mr. Chairman, I'm going to take about as long as Mr. Baker, so please indulge me. It's going to take—this is of such great importance to so many people, that I just can't say it in 5 minutes. I do think it's important to walk my colleagues through this.

Like most of you all during the August break, I took a couple of days off. Like most of you all during the August break, at night I gave speeches. But on the nights when I didn't give speeches, I made shutters. I bought $2,000 worth of plasticized decking. No telling how many hundreds of dollars worth of stainless steel screws, deck caulking, and every night I made at least a pair of shutters, and many nights as many as three.

On the weekends, when my son wasn't working, we installed those shutters. I come from hurricane country. Preparing your house for a hurricane is not only a part of your life, it's a part of your job as a dad, to show your son how to do it, just like my dad showed me.

On the day of the storm, we actually finished installing the last pair of shutters, about 3:00 in the afternoon. The wind was kicking up to about 30 knots, and you can imagine how much fun it is being on a second story ladder trying to hold a drill in one hand, a screwdriver in the other, and a 50-pound shutter in your third hand, while your son is helping you.

We got them all up. And then the routine is you move inside, and you start taking your furniture—none of which would be fancy by your standards—but you take the least desirable furniture, and you put it on top of the kitchen counter. You take the stuff that's a little bit better than that, you put it on top of that. You take the stuff that you might have inherited from your folks, and you put that on top.

Again, I live in a place that's only 14 feet above sea level. But in the 28 years that I have lived it, I have never lost a shingle; it's never flooded. But I do know that in Hurricane Camille it took about 2 feet of water, and that in Hurricane—I'm sorry, about 4 feet of water. And Hurricane Betsy took about 2. We live in an area that comes to accept that.

But the point that I'm trying to make in all this is there are some cynics in this town who would have you believe that somehow the people of Mississippi weren't prepared for the storm, that they didn't take the steps necessary to protect themselves. And that's shear nonsense.

The people of Mississippi—what happened in my home was going on in every home in south Mississippi simultaneously. Fathers and sons were buying plywood, boarding up their windows. They were taking the family possessions and trying to get them up off the ground if they thought their house was going to flood, or if they thought the roof was going to get blown off, or trying to find some common ground, as I did, when you imagine that both things could happen. And you want to take those things that are precious to you and try to protect them.

My wife, simultaneously, was taking the family photos, putting them in Rubbermaid tubs, and taking them with us when we left. She had learned that lesson because both of her grandparents lost everything they owned in Hurricane Camille, including the family photos. And so, again, you learn to cope with this. It's just a way of life. It's like a disease. You try to prevent it, but you know if it comes you take the necessary steps to minimize it.

So, for those people who were saying that somehow the people of my district, or any district, are trying to game this into getting rich, don't kid yourself. Every one of us would rather have our houses back. All we're trying to do is help make people whole.

Historically, it is a place where people stay for a long time. My family has been there for 53 years. We're relative newcomers, but the old timers can tell you about the storms in the early 1900s. They can tell you about the 1947 hurricane, the storm in the early fifties, Betsy and Camille. They can tell you about lashing a wooden skiff behind the house so that when worse came to worst, you pulled the skiff up, you put your family in it, and you went inland.

In the case of my neighbor, Larry Larue, if it was a mild storm like Betsy, he went to his daughter's house a quarter of a mile away. If a bad storm like Camille, he went to his brother's house a half-a-mile away by boat. Again, you deal for this. You know it's coming, and you take the necessary steps.

What I am asking today, though, is to help those people who could not have envisioned this storm being as bad as it was. You see, houses that made it through Betsy, houses that made it through Camille—like mine—no longer exist. They are gone. There is nothing there but a line of debris.

And you could say, "You should have known better," but these places were there, in many instances, since the Frenchmen landed in 1699. They were also backed up not only by local knowledge, but by the knowledge that our Nation provides for us the Federal Flood Insurance Plan.

One of the things I would like to point out is that there will be some people who say that, "You should have known your house was going to go, you should have bought flood insurance. And if you didn't, shame on you."

This is a Federal flood insurance map drawn by Government experts in Long Beach, Mississippi. This area fairly close to the water is the flood plain. As Congressman Baker pointed out, if you live in this area and you go to buy a house, your banker is going to tell you you have to have Federal flood insurance. They won't guarantee your loan if you don't have Federal flood insurance. So everyone in this area buys it. I was one of those people who lived in an area that required Federal flood insurance. I had it.

This is the map that another Government agency, the Corps of Engineers, tells us—the exact same block. Remember? One was very close to the water. This is what the Corps of Engineers tells people south of Mississippi that in the event of a bad storm, "All you guys need to get out of here."

So, we have the National Flood Insurance telling folks basically just down here you need to worry about a storm, but the Corps of Engineers telling you all the way up here—now this is about 10 miles—"In the event of a bad storm, you need to get the heck out of there," based on Government information.

This is what happened in just one of the towns I represent. This is Long Beach, Mississippi. Now it's a little strange looking at it from the sky, but it's the same map as the first one. This lighter stuff that you're seeing is debris. It was people's houses. You don't see any big chunks of houses because they have been just broken up into small pieces again.

What you will find very interesting is, again, that flood line of where you are required to have Federal flood insurance because the American experts told them so is about right here. What this is is a 100-foot-long barge that at light draft draws 3 feet of water, but this one was full. So it draws over 6 feet of water. It's several blocks inside where the Government—I'm sorry, it's several blocks above where our Nation's experts told these people they had to have Federal flood insurance.

This was a casino barge. Used to be down here floating. It's now on the wrong side of Highway 90. This is another barge on the wrong side of Highway 90. The storm surge, as you can see—this is where it ended; this is where the pieces of people's houses ended up, well beyond what our Nation's experts told them the storm would take them to.

Now why do I say all this? The point is not to help me, because I had flood insurance. It's to help those tens of thousands of south Mississippians and south Louisianans who lived outside of the flood plain that our Nation's experts told them they should expect, who their bankers, like Congressman Baker just told you, said, "Look, you're outside the flood plain; you don't need flood insurance, no use wasting your money." And it is relatively inexpensive.

But I will take it a step further. In August, the Consumer Federation of America, the folks that are supposed to be out looking for us, helping us out, actually issued a press release talking about ways that people waste money on insurance. One of the things they listed in the way that people waste money on insurance, one of the examples was those people who live outside the federally-mandated flood plain who buy flood insurance.

So when you say that maybe these guys should have known better, I hope I have provided you with some examples of why they don't. And there is probably some people who say, "Well, they are just dumb Bubbas." You know? "Who cares about them?"

Well, Jerry St. Pe, the former president of Ingalls Shipbuilding, 13,000 employees, builds one half of our Nation's surface fleet, isn't a dumb Bubba. Ricky Matthews, the publisher of the Gulf Publishing Company, his son Harold, is not a dumb Bubba. U.S. District Judge Lou Guirola, appointed by this administration, is not a dumb person. My predecessor, Cy Faneca, one of the smartest attorneys in south Mississippi, is not a dumb man.

What all these people have in common? They lived outside the federally mandated flood plain; they did not have flood insurance; and they are getting no coverage. Now, why are they getting no coverage? Every one of them had wind insurance, every single one of them. But if you read down in that wind policy, there is a provision in there that says if there is wind-driven water, they don't pay.

So, if the wind knocks a tree into your house during the storm, you're okay. If the wind blows your neighbor's house into your house during the storm, you're okay. But if the wind generates a 30-foot wall of water that caused the kind of devastation—that's just in Long Beach; there are actually places worse than Long Beach—a 30-foot wall of water that picked up the Bay St. Louis bridge and threw it over in the bottom of the bay, you're not covered.

I'm trying to make those people whole. Like the rest of us, they probably had credit card bills. Like the rest of us, they had mortgages. But now, unlike the rest of us, they suddenly have a house that's either uninhabitable, at best, or gone, at worst. And their insurance company is saying, “We’re not going to pay you a dime because that was water and not wind.”

There are a couple of ways we could address that. We, as a Congress, don’t make the sun rise and set. But we, as a Congress, do decide what to call the number of—the time of day that that sun comes up and the sun goes down. We call it Daylight Savings Time.

We, as a Congress, could say to the insurance companies, “That was wind-driven water, that 8 inches of rain don’t cause a 30-foot flood of water, and you are going to honor those insurance claims.” I’m not so sure that my colleagues are willing to do that.

Second thing we could do is just come up with some money, just give them a grant. Again, I got here; I got elected on the day of the San Francisco earthquake. One of the first things I did was to vote to help those people. Since that time, there has been a big flood in the Midwest. I voted to help those people. Hurricanes in South Carolina, in Florida, Texas, I voted to help those people.

So we could just vote to give them some money. Or we could take a third step. And we could allow those people—prudent, smart people, who lived outside the flood plain, who weren’t required to have flood insurance, but now find themselves in this horrible bind—we could allow them to pay 10 years back premiums, take a 5-percent penalty, and then file a claim up to the value of their wind coverage, or the $250,000 that Mr. Baker told you about, whatever is less, and file a claim as if they had been in the program all along.

Furthermore, much like Congressman Baker is telling you about, we would then require them to stay in the program as long as they own that house so that they can’t game the system, get a check today, tell us goodbye tomorrow, and so that they don’t file the multiple claims that he is concerned about. And I share his concerns.

That’s what the legislation does. I am very fortunate to have about 40 of my colleagues co-sponsor it. I am very fortunate to have Congressman Frank help us put this together. It has been endorsed by the Mississippi mortgage lenders; it’s been endorsed by the Mississippi bankers. I would hope it would be endorsed by you.

You know, basically what it’s doing is in a time of severe—and believe me, you guys have been great. Every one of you, at one time or another, has walked up to me since the storm and said, “What can we do?” This is something you can do.

I am asking basically the same thing we asked for as congresspeople. We got here because we asked other people to help us, and we got here—and the other thing we got in our lives is every one of us got a second chance. I am asking to give the little league coach, the preacher, the people who have invested in south Mississippi a second chance because if they don’t get it, tens of thousands of Mississippians will have their mortgages foreclosed. We can sit back and do nothing, or we can help them. I am asking you to help them.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Gene Taylor can be found on page 140 in the appendix.]

Chairman NEY. Thank you. I want to thank both gentlemen for your very compelling testimony. And I will turn—are there questions of the members? Gentlelady from California?

Ms. WATERS. Yes. First, let me just say to the Members representing these areas that you are absolutely correct about the feeling of your colleagues about what you are going through and what your constituents are going through. And we certainly appreciate each—everything that you do to try and make your constituents whole, to try and help them. This has been a monumental disaster. We all recognize that, and we want to help.

I am listening to the bills that you are proposing, and of course I want to take a close look at them to see if there are more questions that I may want to raise with you, starting with you, Mr. Baker.

I want you to know that even though you describe this as not being taxpayer money, that we care as much about constituents who pay premiums as we do about just taking the money from the Federal coffers if there were no premiums involved. We believe that these people should be respected, and we should do everything that we can to help them.

When you talk about creating a new authority, does this mean that this overrides the city role and the State role in helping to bring about some relief and some rehabilitation? How has this idea come together? Are all of these entities involved in some way? Who is the appointing authority, and who will run this authority? Who will sit on this authority?

Mr. BAKER. As you are aware, Mayor Nagin has appointed his commission; Governor Blanco has appointed her commission; the President has said he would like to see the redesign of communities adversely impacted be built from the bottom up, meaning local community, homeowners, elected officials, local planners come up with the ideas of how they would like their community to be restructured.

The proposal that I am offering is only the mechanism by which we pay for whatever it is the local community decides should be done. Public hearings, involvement—as I indicated in my testimony, if an individual doesn't want to participate, you can stay right where you are with whatever asset you have got, and you are outside the process. If you want to take money and move on, we provide that option. If you want to be a partner in the development, we provide that option. If you want to take money, and wait and see, and come back and buy in later, we provide that option.

This is a homeowner-sensitive plan where homeowners decide what should be done with their property. We merely provide mechanisms for them to have choice. It does not require that anyone take any step at all.

But when you are very pragmatic about the problems we face, if you look at Mr. Taylor's community where there is no fire station, there is no police department, there is no school, there is no bakery, there is no daycare, who goes in first?

We have to have levee restoration first, environmental remediation second, to get the bad stuff out, and then we need to prepare large tracts of land for development to occur. The plan can be generated at the local level. The debt that will be issued will be approved by the Treasury.

The commission, which—will be a presidentially-appointed commission with the Governor submitting names for positions on the commission to be appointed by the President, and it's the meeting of what I call taxpayer accountability to your constituents with local planning saying how we would like to have resources deployed, done in the full light of day where everybody can understand where their stake is in the future development.

It is not an attempt to take anybody's property away from anybody.

Ms. WATERS. Is the debt scored against the budget?

Mr. BAKER. No, it is not. And let me also quickly add that if this tract looks like this table, and it's clean, and we have a plan developed by the community, and we have 10 guys who come in and submit proposals, then the commission can accept which proposal they think makes the most sense, not just from a taxpayer view, but from a community view.

So if a guy has got green space, he's got all sorts of community services involved in his proposal, that's the proposal we take, and that's the taxpayer take-out. They buy the land back from the commission for their development purpose. So that's where the taxpayers get some relief.

This is different. We have never done it this way before, but there are models. We have had three different Government agencies in our history which have been real estate acquisition and disposition entities, and this is modeled after those.

Ms. WATERS. But a little aside from this—and if you will bear with me, Mr. Chairman—I had not intended to ask this question, but because I am so deeply involved in the issue of eminent domain, I want to ask it of you now.

As you know, the Supreme Court decision in Callo basically allows for the taking of private property for private use. Would you support efforts that are being put together here in Congress that will protect those homeowners from having their property taken for private use, private property for private use?

Mr. BAKER. Certainly. And as I said at the outset, if an individual chooses not to participate, wants to take their land, as it is, without any——

Ms. WATERS. That's okay. That's fine. I got that.

Mr. BAKER. And secondly, the only utilization of the authority of eminent domain would be if you decide to sell, and if you are negotiating price—and keep in mind, you have decided to sell, and you want to move on—that a dispute as to value will enable us to take property and then litigate value in court so the development may proceed.

But it is only after you decide that you want to dispose of your asset that the right of eminent domain may be deployed. And it comes after a very extensive process. But as to utilization of an individual's property——

Ms. WATERS. In the taking of land for a public purposes——

Mr. BAKER. Correct, I understand.

Ms. WATERS.—fair market value is decided. What would be different in this situation that you are describing?

Mr. BAKER. Well, only that the individual thinks the fair market value is different from that established——

Ms. WATERS. But that's not how it works in eminent domain for public purposes. An individual may ask $1 million for a $200 piece of property, but fair market value ends up ruling the assessments that are done.

Mr. BAKER. You do have a judicial right to dispute——

Ms. WATERS. Yes.

Mr. BAKER.—to go to court——

Ms. WATERS. Yes.

Mr. BAKER.—to litigate that value. And that's all that I am saying. While that litigation dispute is ongoing, you cannot then hold up the recovery of a community where your property is essential for that public purpose to proceed.

Ms. WATERS. So you would support, under some circumstances, the taking of private property for private use?

Mr. BAKER. In this case, it's taking a private property for a public use. The restoration of communities is a public use. If I were going to take your property and turn it into a casino, I would have a problem with that. If I want to take your property and turn it into a city, I think that's a public use. What we are doing here is restoration of cities.

Ms. WATERS. Well, that is going to be an issue that a lot of people would have to take a very close look because the implications are so great, and we—this is a great opportunity to watch and see what happens, not only with that Supreme Court decision, but what we are able to formulate here, as public policy, to deal with that particular issue.

And finally, let me just ask you some questions about mapping because you are very knowledgeable about the flood insurance program, and one of the big complaints, as I remember it, is that the mapping is outdated, that it did not take into consideration, often times, the flood plain areas, et cetera, et cetera.

And if that is true, does Government bear some responsibility in a very special way if people thought they were not at risk because of the outdated mapping or the incompetent mapping in these areas?

Mr. BAKER. You are correct. A flood is an animal. It changes shape every day. If you are living in a community that historically had no flooding problem and there is a development above you in the flood plain—a shopping center where now you have concrete where there once was grass—if downstream maintenance by another political subdivision has not kept pace and there is growth in the drainage outlet so you have more water coming down more quickly with an inhibited ability to drain water, historically, that got out, in consequence is the person in the middle of that pipe gets flooded.

It's not of their own making. It's not even within their political jurisdiction. But the consequence is water is in their home.

The mapping really needs to be done almost annually because the dynamics of development and the inhibitions to drainage are continually changing. We have snapshots. And we say, "Because you look like this, in March of 1984," or whatever the date might be, that determines whether or not you are compliant with the rules. That is a very unfortunate system.

Given our technological capabilities today, it ought to be an annual assessment requirement. At least a fly-over with aerial photography——

Ms. WATERS. Will that be reflected in your legislation?

Mr. BAKER. My legislation only deals with the recovery of the——

Ms. WATERS. It does not deal with the mapping problem?

Mr. BAKER. That's correct.

Ms. WATERS. Okay. One more—this is—I'm so sorry.

Mr. BAKER. I've got one answer left.

Ms. WATERS. I beg your pardon?

Mr. BAKER. I said I have one answer left, so let's——

Ms. WATERS. No, I bet you got a lot. I've never known you not to have an answer.

[Laughter.]

Chairman NEY. Let's just compromise, one question and one brief answer.

Ms. WATERS. Well, maybe I don't have another question. So you can reserve that answer.

Mr. BAKER. I will save it for next time.

Ms. WATERS. No, you give it to somebody else. I know you are just waiting to do it. Okay, thank you very much.

Mr. BAKER. I thank the gentlelady——

Chairman NEY. If there are no further—Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I was down in New Orleans last Sunday and saw the tremendous devastation, not only just in the New Orleans area, but then we flew out to the LaFayette area and flew over the rural areas. And you know, we've got people who have lost all of the infrastructure that's necessary to carry on their agricultural activities.

I think in some ways I associate myself with both of your remarks because one is the frustration that we have insurance companies that are carrying insurance in that area, and yet they have excluded, you know, maybe the greatest risk in those storms.

I know that, from a home-building standpoint, being a former home-builder, we have done a lot of innovation as far as building new structures and buildings to where they are able to sustain the high winds of hurricanes. And so, from a wind standpoint, we have been able to mitigate a lot of the damage that occurs from the wind.

But I almost think, Chairman Baker and Congressman Taylor, I mean, one of the things we may need to look at is coastal insurance and not just hurricane insurance or flood insurance. But maybe what we need to look at—and I agree with what the gentleman said about the technology today—we have the ability to fly over those areas, digitize them, and then model what could occur in certain kinds of storms.

And certainly we're not going to be able to model every storm that occurs, but I think we can do a better job of modeling that.

Then, I think we've got to take that modeling data to the insurance industry and say to them, "Let's come up"—and I think also to allow people to carry coverage that the risk they're taking, that if I'm going to go build a $1 million home on a beach area, that I am responsible for covering the risk that I am taking. But we have to provide a product for them to cover that risk.

And I have dealt with flood maps, and they are easy to amend. And basically, what we're talking about is rising water in a rain-storm, most of the time of just falling rain or rising water in—from other drainage areas.

But I think one of the things that's not in place, and what's so terrible about that, is that we have got people in three States now waiting to see what the United States Congress is going to do so that they can get on with their lives.

Where if in place they had a coastal coverage, it's a question of adjusters coming out and saying, you know, "Here is—you have sustained a loss, and here is your check," and then people can make the decisions that they need to make to go on with their life.

Chairman Baker, I like your idea because one of the things that struck me when I was in New Orleans, being in the land development business, is that what needs to happen is there needs to be a market-driven activity developed into that plan. We can't assume that everybody is coming back to that location. And there may be areas that are not going to be adequately protected in the future, and those areas will have to be dealt with.

I want to look more at your plan, but I do like the fact that it provides a basis for some private activity. I think that if we send a signal to those States that the Federal Government is going to come in here and try to fix all of this, the private sector will stay home. I do not think they will participate.

But I think if we provide an adequate environment where the private sector can come and participate, where we have then a plan in place, or a coastal coverage in place, where if I'm going to come back in to New Orleans, or going to come back in to Mississippi, that—and I'm going to build that home—that if I build it, I can cover the risk that I am taking of building that.

So I think a multi-faceted plan has got to really think coastal flooding, and not just certain kinds of storm surges, but what happens in these catastrophic situations and with the understanding to the insurance industry that we can't cover every risk. There are just certain things that happen. I mean, who knew that 9/11 was—we were going to be worried about airplanes flying into buildings?

But I do believe today, in some cases, the flood insurance program does work. But I think what we have seen in the coastal areas is that we do not have an adequate one. And it has got to be one—and as you said, Chairman Baker—where we encourage participation.

And you can do that in two ways. You can in the quality of the product, but I think you also have to say to Randy Neugebauer that, "If you come and build that million dollar house on the beach, and you don't cover the insurance, it's your risk, and you're not going to ask the American people to take that risk for you." And I think that's a fair thing.

So, I look forward to having some meaningful debate with both members because I think we have seen a hole in the system that we do need to address.

Mr. BAKER. I thank the gentleman, I just want to make a brief response in that in my capacity as chairman of capital markets, which has jurisdiction over insurance matters, we will have a very thorough examination of the practice of how we address the exposure and the risk.

As insurance is constructed, you spread risk across a broad number of participants on the belief that, ultimately, only a certain number of people will make claims and, therefore, it is actuarially sound.

Mr. NEUGEBAUER. That's right.

Mr. BAKER. Today, we have a concentration of loss without a broad distribution of premium payers. And I think it's pretty evident one of the remedies that might be pursued.

Secondly, a discussion going forward about wind-driven water versus wind-driven trees is a pretty intriguing one. And the difference during the storm, if your house burned down you got the face value of the policy. If you bought more insurance than the loss, and it burned, you get the face value. If it's wind-driven, you get actual loss; and if it's flood, you get $250,000. I don't care what you want to buy. There is no logic to that insurance strategy.

And so, we need to have good public discussion, and going forward, talking about how—the risk people face, living in coastal areas.

And the last point. People have to live in New Orleans. Your home heating oil bill will reflect that this year. Your price at the gas pump will reflect it. If you are a Midwestern farmer exporting corn or grain, 65 percent of that goes through our ports. If you like seafood, 32 percent of the Nation's seafood—I mean, fir, for goodness sakes, comes out of Louisiana. I mean, I didn't know that.

We are a big producer of matches. Where did that come from? This area is economically essential, and people are going to go where the jobs are. Therefore, people are going to live next to the coast and have this risk, and we need to have an adequate insurance net to keep a catastrophic loss to the American taxpayer.

Mr. TAYLOR. If I may?

Chairman NEY. Mr. Taylor?

Mr. TAYLOR. To your point—and I guess I'm a lot closer to this than I wish I was, since I'm one of those people whose house now looks like that debris line—what's really frustrating is—and I will point to myself—when the agent came to what was my house, walks around a piece of tin roof that's a half-mile back, piece of slate floor over here, sink is quarter of a block over that way.

And what they do is they say, "Well, we're prepared to pay on your flood insurance," to which I reminded them that's mighty generous of them. "That's Federal money, not"—I won't name the company, "—not your money."

He says, "Well, we're not so sure about this wind policy." What really tens of thousands of people are seeing now, despite the full-page ads being run by the insurance industry saying, "We're there for you," is the insurance industry really trying to find every reason that they can not to pay the claim.

And it really is the little individual down on his luck, worst of circumstances, out of a house, out of a job, still got that mortgage to pay, and the great big insurance company saying, "And by the way, where is the evidence for you to prove that it was water and not wind, and wind and not water," because they're trying to play it both ways.

One of the things that I would hope would come of this—it was after Hurricane Camille, the devastation of Hurricane Camille, that this Nation started the Federal Flood Insurance Program so that people could pay to mitigate their own risk, those people who live in areas that are going to have hurricanes.

But what we have seen is that when you leave a loophole, the smart guy is going to figure out a way not to pay. If the private sector doesn't step up to the plate—and I will leave that "if" there—then I think we, as a Nation, are in the business of looking out for people.

And if the private sector won't do it, then I think we, as a Nation, have a responsibility to do it. And maybe it shouldn't be called flood insurance; maybe it should be called natural disaster insurance so that we, as a Nation, aren't trying to find a reason not to pay people claims, people who have paid their premiums faithfully for 10, 20, 30 years. Maybe we, as a Nation, will treat them a little bit better.

And by the way, Congressman Baker is exactly right. We, as a Nation, doing a pretty good job of paying our claims on the flood insurance program. Yes, the losses are limited to a quarter of a million dollars—and again, in a lot of places that's a lot of money. For some of these newer homes that have been put up in the past few years, that doesn't begin to pay for them. And certainly, raising the cap absolutely is something we need to look into.

But the other thing is, if the private sector isn't going to treat the people of Mississippi, of Louisiana, of Texas, of Florida, South Carolina, wherever it occurs—80 percent of all Americans in the next 50 years are going to live within 50 miles of the coast. And if the private sector is not going to step forward and treat them properly, as someone who has voted for almost every single tort reform measure that has come before this Congress, I will be the first to say if they're not going to do their job, then I think our Nation has to step up and do it.

Chairman NEY. I want to thank you. I want to also remind members we can continue to question, ask questions of the members. We have a vote at 11:45. We do have an, I think, important panel with Mr. Maurstad and Mr. Jenkins, but again, if you would like to ask questions—gentleman from Massachusetts?

Mr. FRANK. Let me first yield to the gentlewoman from California.

Chairman NEY. All right.

Ms. WATERS. Thank you very much, and I will be quick with this, and I would like to ask both of the members if you are willing to support the cost of what you are advocating even if there are no offsets, as it has been discussed by the administration—because I think you have good ideas—when you establish a commission, for example, it costs money. And some of the other aspects that you can't enough determine now will cost money.

And I am feeling very strange by the rumblings that I am hearing that we can't pay for making these citizens whole and taking care of this problem unless we find some deep cuts in other places that offset. How do you feel about that, and are you going to stand up for your constituents even if it costs money to do so that you can't find offsets for?

Mr. BAKER. I come to agreement with you, Ms. Waters, and from a slightly different perspective. To a great extent, I am so overwhelmed by the Nation's generosity, private and public dollars that have been made available to us; we have not been the recipients of that kind of assistance before.

But you have written one check. How do I come back to you and say, "I'm going to cut your programs and make you pay twice?" I'm asking you to make two commitments to me. I'm not going there.

Now, I don't know what the thinking is. The plan I'm putting forward has a provision for the sale of property at the end to get taxpayers some money back. I feel I've got to do that. I feel we need to be very transparent, very accountable, show you where every dollar goes, and if you find something that's wrong, let's correct it. That's the way we—at least I believe—we should conduct ourselves in this disaster.

Chairman NEY. Mr. Taylor?

Mr. TAYLOR. Ms. Waters, I—my vote sent over close to 2,000 young Americans over to Iraq to die. My vote also sent billions of American dollars over there to build schools, build roads, build water lines, build sewer lines. I didn't ask for an offset to help the people of Iraq. I'm not going to ask for an offset to help the people in Mississippi, Louisiana, or Texas.

Ms. WATERS. All right. I yield back to the gentleman from——

Mr. FRANK. I thank the gentlewoman.

Ms. WATERS. Thank you.

Mr. FRANK. And let me just say that I am impressed by the dignity, as well as the moral seriousness, of both answers, and I hope that it becomes the public policy.

I would just say that the gentleman from Louisiana, he has also been in the forefront of our effort—because one of the things we're going to have to do, and obviously there is room for the private sector, but when it comes to building housing to be inhabited by people who are $40,000, $30,000 a year in income and below, there should be no way that's going to be build without some public—some other source of funds, particularly in an economy where people have lost their jobs and have lost what they had.

So I think that makes it all the more important to pass the Affordable Housing Fund, and the gentleman from Louisiana has been working diligently on that. And I hope that next week we can get that through, and that would be another source of money.

Beyond that, I just wanted to ask Mr. Taylor—and I must say this has now started to hit me. People may have been reading or watching on television the story of a dam in Massachusetts that is on distress. It's in my district, in the city of Taunton. I was up there yesterday, along with my Senators bringing our considerable engineering expertise to the job and maybe a little money as well.

But—and it was pointed out to me by Mr. Riley on my staff that, you know, one of the problems is, I guess, if you live behind the dam, you don't have to get flood insurance. I've got people, it now turns out, in my district who may be facing flood damage who aren't insured. And one of the things I will do as of next week when this crisis has passed is to do something that I wish I had thought of before, which is to begin to tell people, "You better buy flood insurance, even though it's optional."

But let me ask Mr. Taylor, because that's something for the future. But for those people he is talking about—and I know there is some reference to million dollar homes, they're doing this—how many million dollar homes in your district are we concerned about, Mr. Taylor?

Mr. TAYLOR. Again, Mr. Frank, I hope I have made it clear—I'm first to admit I'm bad to mumble—I hope I made it clear we're only asking in the bill that you and a number of others have helped me put together to pay up to the amount that people had insured themselves in the wind pool, or a quarter of a million dollars, which is the existing limit in the Federal Flood Insurance Program, whichever is less.

Mr. FRANK. Thank you.

Mr. TAYLOR. If someone only thought enough of their place to insure it for, for example, $160,000 in the wind pool, there is no reason for the taxpayers to insure it to the——

Mr. FRANK. All right, then let me ask you this. And I do think—and you've done this, and it's painful, but I—and we often, when we are focused on legislation, talk about what people think will be the problems if we pass it.

If we do nothing, if we don't pass the bill that you have sponsored, that I'm proud to co-sponsor, or we do nothing else to deal with the situation and the people whose housing losses will not be covered—and there will be lawsuits and things, but I'm not optimistic, I must say, and you've said the notion of—likelihood of us passing a bill that makes that decision about what coverage is, I think, is even less likely than your bill—if there was no congressional action, if things don't change and the current situation doesn't change, what happens to the people in your district?

Mr. TAYLOR. Well, again, I am very appreciative that the President of the United States has been down to the district probably five times. I'm very appreciative that many of my colleagues have taken time out of their busy schedule to go see. Because even though you can see it on television, you really don't get a grasp for just how bad that is until you stand and look at that mountain of debris.

The likelihood that tens of thousands of south Mississippians will lose their houses as a result of this is extremely high. The President's plan calls for tax breaks for people who come in from outside, invest in places like these down in Mississippi, and then after they fix something up and sell it high, they get to get those profits tax free.

Well, that's great for the fellow who comes in and preys on the misery of the poor guy who has got to sell his house. It does absolutely nothing for the poor guy who has got to sell his——

Mr. FRANK. What happens—if they lose their houses, what is the prospect for all these people—working people we're talking about, maybe making $30,000 or $40,000 a year—what is the prospect that, having lost the house they had and lost the money they had sunk into it, and lost the downpayment, lost whatever mortgage payments, what is the prospect for large numbers of them getting a new house? How is that going to happen?

Mr. TAYLOR. I think, Congressman Frank, you can answer your own question. I mean, two bad things can come out of this. They can have on their record that the bank foreclosed on their mortgage, or they can have on their record that they, you know, bought a house for $100,000 and sold it for $20,000 and that because of that then, therefore, could not pay off their credit card bill, could not pay off other loans that they may have had out. Their credit history is probably ruined from that point, and their chances of buying another house have been substantially diminished.

We can try to make those people whole. Not even whole, just make them closer to where they were the day before the storm. Every one of them would rather have their house back. But at least we're saying that we, as a Nation, are going to step up and try to help you save your house. And again, I appreciate my colleagues who have signed on to this bill.

Believe me, if we could think of a better way, I would welcome anyone's thoughts on a better way to make these people whole.

Mr. FRANK. Thank you. And Mr. Baker indicated that he had something to add.

Mr. BAKER. I just wanted to contribute. I come at it with a similar motive but a slightly different direction, with the Recovery Corporation, where we do provide for a mechanism not to make whole, but to provide for some reimbursement at the owner's choice: cash, move on, stay part of the new development——

Mr. FRANK. Let me ask you, too. Your bill is Louisiana-specific. Is there any reason why that couldn't be broadened, or——

Mr. BAKER. The only reason it is Louisiana-specific is because of the varying amount of debt that would be issued between Texas, Louisiana, Mississippi, Alabama, and we don't want to have States competitive within Treasury——

Mr. FRANK. But the logic of your proposal would be that each State should have their own——

Mr. BAKER. Yes, that is correct.

Mr. FRANK. Thank you. Thank you, Mr. Chairman.

Chairman NEY. I would like to move on to the second panel unless members have a compelling desire to ask questions.

Mr. PEARCE. If you don't mind me making a quick comment—and I understand the sensitivity of the matter—I will just tell you—it needs better explanation—but in understand that we need to get to the next panel; the devastation is apparent. But I will tell you that there are single individual losses that occur every day that, because they don't have the visibility, will never get paid. And we are asking people who are devastated individually to pick up the burden.

And I would use examples of ranchers on the border that, due to the policy of our U.S. Government, we have fences stolen and the Government will not reimburse that. And people say, "Well, they should be ranching at a better place; they should have known," same things that Mr. Taylor is saying, that they should not be on the border of where the people come up to the border and steal their goods.

Just south of my district in Texas, the town of Zaragosa, Texas, about 15 years ago the entire town was blown away by a tornado, and it was not rebuilt with Federal funds.

When we look at compassion—someone said if the private sector is not going to pay, we, as a Nation, should pay—when we begin to use the Government for compassion, I will tell you it is very difficult because compassion to one is uncompassion to another. And if we go back and review the decision to pay the people $1 million-plus at 9/11, it was full of compassion, full of heartfelt understanding of the loss.

But what it said to the families—my district was the one who was at Bataan, it was the Mexico National Guard that served and died in the Bataan Death March—and what it said to those people who lost loved ones in Bataan is that, "Your loss is somehow not compensationable." That's not a very good term, but we are not going to compensate your loss, but we are going to compensate the victims of 9/11 because it is so much more apparent, and it is so much more—we have got the political desire to do that.

I will tell you that we are all going to wrestle with this problem. I understand the economic devastation, but keep in mind it was in my district, a district with no earthquake experience throughout our history, and about 15 years ago an earthquake came. We've got oil wells which stick 7,000 and 10,000 feet deep, and those oil wells were completely broken.

There was no one there to say, "We should pick up the pieces for you; we should try to recreate the jobs; we should do these things." And I will tell you that as emotional as it is, if we pay for one and don't pay for every one, we are making some judgement errors that we will live with a long time. Thank you, Mr. Chairman.

Mr. TYLER. You know, I hope you know I pride myself on my desire to balance the Nation's budget. And we probably look at this differently. I voted against almost every tax break because I didn't see how we could simultaneously increase spending, cut taxes, and somehow make it all work, and prepare for things like this and future wars.

I guess what is different is the scale, quite frankly. I also feel fortunate to know people who have survived the Bataan death march. I know a guy who at 16 received the Congressional Medal of Honor, lied about his age to get into the Marine Corps, dove on two hand grenades at the Battle of Iwo Jima. He's a south Mississippian.

There are 38,000 people in south Mississippi who don't have homes. Seventy percent of the people in my home county either have no home or now own a home that is uninhabitable. I think it's the shear scale of it. And I do understand we can't do everything for everybody.

But, you know, there is going to be some cynic out there—maybe one of the next panelists—who is going to say, "They should have known better." You know, that blind cleric by the name of Raman got a guy to drive a truck full of explosives into the twin towers with the idea of setting off an explosion in the basement, toppling one tower into the other, and killing all the occupants. That happened around 1994.

I guess a person could say, "Well, those people should have known it was a target of terrorists," but I didn't say that. I voted to help make those people's—I can't bring back the people who died, but I tried to make the people—the lives of the survivors a little bit better. I thought it was a prudent thing for our Nation to do.

And you're right. When you consider that compared to what happened at the Bataan Death March, or the people in World War II, the guys who were slaughtered on the beaches in Normandy, you can't make every wrong right. But you can do some things. And those things we can do, we should do.

Chairman NEY. Thank you. Mr. Blumenauer?

Mr. BLUMENAUER. Mr. Chairman, I appreciate your courtesy in permitting me to sit in on this. I want to commend these two gentlemen for the big picture that is being offered up. And I am hopeful that there is a way to approach it in the spirit that I think in which it is offered.

I think we heard people ask for tweaks. We have been privileged to work with Mr. Taylor as he has brought this concept forward. But I think we are putting on the table two big items in terms of scale of reconstruction and type of partnership.

I commend Mr. Baker for calling the question, and look forward in various committees, how we can come together to see what can come from this challenge. And his approach is the biggest scale I have seen to this point, and I think it is worthy of serious consideration.

And I appreciate Mr. Taylor and the work that he has done in terms of calling the question about the nature of the flood insurance program and how this committee has already acknowledged that more money is going to be needed anyway. This is an opportunity to deal with this issue in a more comprehensive way keeping the integrity of the program, but dealing with people who have really been taken unawares.

I appreciate the spirit with which both gentlemen have offered their proposals and the way the committee has been approaching them. And I think there are lots of us on the outside world that would really love to continue working with you and with them because this is the sort of thing that I think is ultimately going to get us to the situation and resolving it.

Chairman NEY. I am sure that this will not be the last of these discussions. Any other members? Mr. Melancon?

Mr. MELANCON. I want to thank both of my colleagues, Mr. Taylor and Mr. Baker, who I am proud to say I served with. The efforts are good. We have got a long way to go.

To the gentleman who was concerned just a minute ago, just for the record, tornadoes are covered by property insurance policies. So if they rebuilt, if they had insurance, they didn't have a problem.

This is a situation where people had insurance, and they are not covered. And this is a situation where in St. Bernard Parish alone I think the number is 24,000 or 34,000 homes are uninhabitable and not covered if the insurance companies have their way, by the policies that they thought would take care of them.

Mr. BAKER. If the gentleman would yield on that point, I have also learned that when a properly conducted business owner acquired business interruption insurance, if your supplier was in Orleans and the supplier was wiped out, you're covered. But if your business was in Orleans and you were flooded, you're not covered.

Mr. MELANCON. That's right.

Mr. BAKER. So smart business people buying product they thought to protect them prudently turned out not to be so prudent.

Mr. MELANCON. Thank you, sir.

Chairman NEY. Any other members?

[No response.]

Chairman NEY. I want to thank both the gentlemen.

Moving on right away to panel two, I think what we will do is have a vote. We should probably do that and come back. I won't return; I have got another appointment—I thought this would end by noon—but somebody will be here, you know, obviously, to chair.

So I just wanted to make one comment because I won't be back here. I think that if we—well, my question is going to be—and it will be asked for me—is, is the White House actually going to submit a request for—to up the debt relief.

And just a personal opinion, if that happens, we ought to have instantaneous accurate mapping if we are going to spend all that money.

On another note, we would remind members that you are not going to be able to answer all the FEMA questions that we want answered about housing and situations like that. But as a personal editorial, if we are looking just for FEMA's information—not yours—but if we're looking for helping people down there, taking away Davis-Bacon living wage is not a way to help people down in that affected area.

With that, we will recess.

[Recess.]

Mr. PEARCE. [presiding] The meeting will come to order. Our second panel is Mr. David I. Maurstad, acting director and Federal insurance administrator, mitigation division, the Federal Emergency Management Agency, the emergency preparedness and response director in the Department of Homeland Security. And if he has to announce his title every day, it takes about a third of the work day just to say that.

And the second witness will be Mr. William O. Jenkins, Jr., director of homeland security and justice, U.S. Government Accounting Office.

Mr. Maurstad?

STATEMENT OF DAVID I. MAURSTAD, ACTING DIRECTOR AND FEDERAL INSURANCE ADMINISTRATOR, MITIGATION DIVISION, FEDERAL EMERGENCY MANAGEMENT AGENCY, EMERGENCY PREPAREDNESS AND RESPONSE DIRECTORATE, DEPARTMENT OF HOMELAND SECURITY

Mr. MAURSTAD. Thank you, Mr. Pearce, members of the subcommittee. If I can have the written remarks part of the record, I will——

Mr. PEARCE. Could you ensure that your microphone is on and pulled up close?

Mr. MAURSTAD. Yes, sir. Is that better? Thank you. And let me first say that I appreciate the opportunity to appear this afternoon. I have personally observed the area down in the Gulf Coast area, the damaged areas, and been there and witnessed the devastation that was talked about earlier, and have been working with the insurance commissioners of the affected States, and want to continue to express my sympathy and prayers for all of those that are affected.

I would like to focus my remarks, oral remarks, on the financial condition of the National Flood Insurance Program, as seen through the prism of Hurricanes Katrina and Rita.

However, I want to take the opportunity, in addition, to emphasize that NFIP is more than just an insurance program. It is flood risk identification, the importance of which is demonstrated with the 5-year $1 billion flood map modernization effort that is underway with the support of Congress and the Administration, which leads to an important aspect, and that's the company participation and community participation in the National Flood Insurance Program.

There are over 20,100 communities that voluntarily agree to participate in the program. Part of that agreement deals with the mapping. The Federal Government doesn't impose the referenced maps on local communities. Communities agree to participate; they agree to adopt the flood maps to guide them with the second aspect of what I want to share with the committee that deals with flood plain management.

So when they adopt those flood maps, the proposed flood maps that we provide to them, they are adopted on the basis that that is the minimum requirement to participate in the National Flood Insurance Program. Communities have the ability to adopt maps that go beyond the 100-year flood, and many communities do do that.

The sound flood plain management component of the NFIP saves this country an estimated $1.1 billion in preventative flood damages annually. That means that since 1996, the Nation has reduced the risk of flood by $10 billion. In addition, the structures built to NFIP criteria experience 80 percent less damage than structures not built to those standards.

Having said that, let me return to the financial situation of the National Flood Insurance Program on the heels of Katrina of Rita. On September 20, 2005, the President signed H.R. 3669, which increased the NFIP's borrowing authority from $1.5 billion to $3.5 billion.

However, as Katrina and Rita-related claims will exceed this amount, I am authorized to request from the committee that $5 billion be added to this authority. This stop gap measure should allow sufficient borrowing authority to cover claims through mid to late November, which would enable us to work with this committee and others to complete meaningful program reform recommendations.

It is also important to note that since 1986, the NFIP has been financially self-supporting. During periods of high losses, the NFIP has borrowed from the U.S. Treasury, which is an essential part of NFIP's financing for heavy loss years. These loans have been repaid with interest from policy-holder premiums and related fees at no cost to the Nation's taxpayer.

Hurricane Katrina was a catastrophic event, going well beyond what the NFIP was intended to address from premium revenues alone. In that context, let me refer to the charts that have been provided to subcommittee staff and, hopefully, are available to you.

I direct your attention first to the chart that is about National Flood Insurance Program Estimate of Ultimate Paid Losses from Hurricane Katrina. There is a similar report——

Mr. PEARCE. Which panel—which sheet is that, CRS37?

Mr. MAURSTAD. I believe I provided these charts to staff, along with the oral testimony, sir. And we have copies if you need copies. Do you need copies? There should be three documents——

Mr. PEARCE. Yes, you can go ahead. Thank you.

Mr. MAURSTAD. Okay, thank you. Two of them are identical in format, one dealing with losses from Hurricane Katrina, and the other from Rita. I'm not going to go through this chart line by line. I just point out to you that this is the basis by which we have developed what we believe that the ultimate paid losses from the hurricanes will be, broken down by State and by affected counties.

What we have provided in that is the total policy in force in a particular county, the total coverage associated with those policies and then as you move across to the right, what we estimate the assumed frequency for the number of losses on that total policy count, which leads us to the next column, which is the estimated number of claims that we are looking at for that particular county.

The next column, we estimate what we believe to be the severity of the individual losses, with the final column being, of course, the total of the estimated number of claims times the assumed severity.

If you go down to Louisiana, we also break that severity down to a little bit finer level in the assumption of the percentage of claims that would be paid at policy limits, those that would have a $40,000 severity, and the remaining at $50,000 severity.

So we have used this as the guide, in addition to the information that has been generated from our requests from the 96 write-your-own companies. But primarily in this area there are about seven major insurance companies that administer the National Flood Insurance Program on behalf of the Federal Government in our what was biweekly calls and now weekly calls and the reporting that we have set up for them to tell us the number of claims that they are getting reported.

And as time goes on, when those claims are being closed, and the amount that they're being closed, so that we can keep as close an accounting, real time, as much as possible, given the circumstances, so that we know what to present to you as to the condition of the fund is.

The third sheet that we provided is the projection of the Federal cash flow from the claim payments, and which is guiding us to— it is the basis by which we requested the additional $2 billion of borrowing authority and now are requesting an additional $5 billion of borrowing authority.

And you can see that our expectation is, on a weekly basis, that by mid to late November, our current borrowing authority will not be sufficient to take care of the claims that were expected to be closed and payments made to policy holders during the period between now and then, and then we carry that on out to the ultimate of $23 billion being the expectation for this event.

I indicated in my written testimony how that compares with historical, and it clearly is many, many, many times beyond what the program has ever experienced in the 38-year history.

Let me conclude my comments and then be certainly available for questions, either about the reports or my testimony. The $23 billion in estimated claims from those whose homes and businesses have been damaged or destroyed by Hurricanes Katrina and Rita is not a new obligation. It is the result of a legal promise we made to these homeowners and business owners when Congress passed the National Flood Insurance Act of 1968 and the subsequent revisions.

Homeowners and business owners agreed to pay the premiums; communities agreed to adopt building codes to mitigate flood damages; and the Federal Government agreed to provide insurance coverage to policy holders after a disaster.

Every single one of these claims represents someone who has taken the responsible course of action by purchasing flood insurance and faithfully paying the premiums. We not only have a legal obligation to honor our commitments, we have a moral obligation to provide the coverage we promised to provide.

To do anything less would not only result in dire consequences for the NFIP, the write-your-own insurance companies whose names are on the policies, and the communities working hard to manage their flood risks, it would simply be wrong.

Once again, thank you for the opportunity to testify. And certainly, as in the past, I'm available to the committee.

[The prepared statement of David I. Maurstad can be found on page 132 in the appendix.]

Mr. PEARCE. Thank you. Mr. Jenkins?

STATEMENT OF WILLIAM O. JENKINS, JR., DIRECTOR OF HOMELAND SECURITY AND JUSTICE, U.S. GOVERNMENT ACCOUNTING OFFICE

Mr. JENKINS. Congressman Pearce and members of the subcommittee, I appreciate the opportunity to be here today to discuss the challenges facing the National Flood Insurance Program.

The devastating effects of Hurricanes Katrina and Rita have placed unprecedented demands on the NFIP. As of October 13th, FEMA reported that 192,809 claims had been filed, and NFIP had paid almost $1.3 billion to settle 7,664 of these claims. This number of claims is more than twice as many as were filed in all of 2004, itself a record year.

The NFIP combines property insurance for flood victims, maps to identify the areas at greatest risk of flooding, and incentives for participating communities to take actions that reduce future flood damage.

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 primarily is to one, establish policies and standards that others generally implement on a day-to-day basis, and two, provide financial and management oversight of those who carry out those day-to-day responsibilities.

My statement today focuses on FEMA's management and oversight of the sales and service of flood insurance policies. FEMA faces a challenge in providing effective oversight of the 96 insurance companies and thousands of sales agents and claims adjusters who are primarily responsible for the day-to-day process of selling and servicing flood insurance policies, including claims adjustment.

About 40 FEMA employees, assisted by about 170 program 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 performance of the write-your-own companies to assure that the NFIP is administered properly. For example, assuring that policies are properly priced, and claims appropriately handled.

FEMA told us that its principal method of monitoring performance and identifying and resolving problems is to conduct an operational review about once every 3 years, of each of the 95 write-your-own companies. In addition, FEMA's program contractor is to check the accuracy of claim settlements, do quality assurance reinspections of a sample of claims adjustments for every flood event.

We examined 15 operational reviews completed from 2001 to February of 2005. We found that these 15 operational reviews met both FEMA's standards for identifying critical errors, such as violation of policy or an incorrect payment, and that FEMA tracked a company's progress in correcting any identified critical errors.

We also found that FEMA's method of selecting the sample of claims for reinspection was useful for identifying some specific problems and risks. But the sample was not representative of all claims settled and, thus, could not be used to assess the overall performance of private insurance companies and adjusters who process claims in a specific flood event.

An instructor for adjuster training cited several problems he had identified in reinspecting claims, such as one, improper room measurements, two, improper allocation of costs caused by wind damage, and three, poor communication with homeowners in the process followed to inspect the property and settle the claim.

Additional payments were made for about half of the 2,294 claims that used the appeals process set up for Isabel claims, principally, for two reasons: the adjuster did not include some items he should, and higher payments for materials, labor, or personal property than originally allowed were allowed on appeal.

FEMA has made progress, but not fully implemented the requirements of the 2004 Flood Insurance Reform Act. For example, in September, FEMA posted on its website its flood insurance claims handbook, which outlined a basic four-step process for appeals, but has not yet completed the design and implementation of its full appeals process.

We recommended that FEMA develop plans that include milestones for completing requirements of the 2004 Act and assigning accountability for meeting those milestones.

FEMA faces a formidable challenge in providing effective direction and oversight for processing the record number of flood insurance claims that have arisen and will arise from the recent hurricanes. This record number of claims only reinforces the importance of effective oversight and the need for clearly defined, understandable, and consistently applied processes for policy holders on filing claims and appealing claims settlements.

It also highlights the need for effective communication with the thousands of anxious policy holders, many of whom have been displaced from their homes and many who have lost everything.

As part of the body of work GAO is beginning on the preparation for a response to and recovery from Hurricanes Katrina and Rita, our work on the NFIP will continue. That concludes my statement, Mr. Chairman. I will be pleased to respond to any questions you or the other members of the committee may have.

[The prepared statement of William O. Jenkins, Jr. can be found on page 55 in the appendix.]

Mr. PEARCE. Thank you. I would yield to myself to start the questions.

And Mr. Maurstad, I guess if I'm looking backwards, it looks like maybe in 2004 we were about $60 million—we had $60 million in the bank right? And then we had the losses of $2.28 billion in 2004, so we ended up borrowing $220 million. And you said that money has entirely been paid back?

Mr. MAURSTAD. We originally had borrowed $300 million earlier this year. We paid back $75 million. And so the statement that we had paid for 1986 now is up to that point in time.

Mr. PEARCE. I understand. But you have—you make—you take loans out and you make repayments. So I am looking at a revenue picture of $2 billion a year. Is that about what the Agency gets in in premiums?

Mr. MAURSTAD. In premiums and in fees from the policy holders.

Mr. PEARCE. About $2 billion in revenues?

Mr. MAURSTAD. Yes.

Mr. PEARCE. Now if I were going to go to a bank and borrow $22 billion with $2 billion worth of revenue, 22 versus 2, I would have to have it amortized over a long number of years. How many years is it going to take to pay back just Katrina?

Mr. MAURSTAD. We——

Mr. PEARCE. Just the $22 billion or $23 billion that you are estimating.

Mr. MAURSTAD. It is my opinion that the program does not have the ability to repay the portion of the—of what we are looking at here, beyond about $1 billion, unless we extend it——

Mr. PEARCE. Okay. So we don't have the ability to repay.

Mr. MAURSTAD. Not——

Mr. PEARCE. And in another part of your testimony, you said that we have made a legal promise. Why are we making legal promises that we don't have the capability to fulfill? That becomes a critical question in the administration of the program.

Mr. MAURSTAD. When the program was designed, back in 1968, and since then, it was designed from the premise that premiums would be generated that would be able to take care of the—an average loss year, and that borrowing authority would be extended to move—enable the program to move from year to year in those ups and downs that are going to occur from an average loss year.

Mr. PEARCE. Basically, you are saying we miscalculated.

Mr. MAURSTAD. No, I'm saying that without—it's my opinion that the idea that if a catastrophic event ever occurred such as we're facing now, that the Federal treasury would be the means by which that difference would be made up, that the program was not capitalized, that the previous looks at whether or not reinsurance made more sense turned out to be more costly than if we continued to work the program based on average loss years with the necessary borrowing authority to get through the ups and downs.

Mr. PEARCE. What—you said that all the check marks—in other words, the responsibility is on the part of others. Your comments were we made a legal promise to pay, but that people have a responsibility to buy; the communities had a responsibility to develop building codes.

And are you telling me that if I am to look at your other sheet showing 235,000 estimated claims, 235,944 estimated claims that the building codes for all of those have been adequately—the check marks have been adequately made and that we have done our due diligence through all parts of society in order for us to say that we have the moral obligation to pay, which is your ultimate conclusion?

Mr. MAURSTAD. It is the responsibility of the program to make sure that the communities——

Mr. PEARCE. And have they done that?

Mr. MAURSTAD.—the——

Mr. PEARCE. And have they done—you said building codes was an important parameter.

Mr. MAURSTAD. Yes.

Mr. PEARCE. And have all the building codes been put in place and complied with?

Mr. MAURSTAD. Yes.

Mr. PEARCE. Could I get documentation to that effect, that you would, in your words, say that all building codes have been put in place, and they have been 100 percent complied with?

Mr. MAURSTAD. When they are—when non-compliance is discovered, either by our inspections and community visits that occur, or if we are made aware of those violations, then we address them and require the communities to rectify the problem, or we go through the process of suspending them from the——

Mr. PEARCE. Mr. Jenkins, in your testimony you have indicated some oversight of—or some looking at introspection of the program. Would in your estimation we have complied with 100 percent of the building codes in the requirements for communities to do their due diligence in these 235,000 claims that are going to be filed?

Mr. JENKINS. Well, I think there is one thing that is in Mr. Maurstad's statement that is not a fault of FEMA, but there is a significant number of repetitive loss properties that by definition don't necessarily meet those regulations because they were essentially grandfathered into the program. And there are roughly 22,000 of those in Louisiana, for example, for which there would be claims.

So, in particular, for the repetitive loss properties—these are properties that were built before the flood maps were created, and when they were built it wasn't known that they were necessarily in a flood plain.

So to the extent that there are these properties in the program—and they are about 24 percent of all the properties that are in the program are in this category—then they don't necessarily meet the building codes.

Mr. PEARCE. Thank you. I appreciate that. Ms. Waters, I yield to you. I will have additional questions, so if you would like to have two sets of questions ready, we will go at least a second round.

Ms. WATERS. Thank you. Thank you very much. I appreciate that.

Mr. Maurstad, there have been, as you know, a lot of criticism and many complaints about the program. I think when you were here before, we requested information from you about interrogatories and document requests that Steve Kanstoroom—several committee members in July.

You answered to the question—you said you had responded, or you were in the process of responding to every request that came to your office. I have not received anything. Have you sent me anything?

Mr. MAURSTAD. Ms. Waters, I regret to let you know that we have not responded to those questions for the record. They are in the concurrence process now, and I am working with my cohorts in the office of general counsel in getting those answers for your questions, and getting them to you and the committee.

Ms. WATERS. How long do you think it will be before we get those answers? What's the time frame?

Mr. MAURSTAD. Very soon.

Ms. WATERS. This year?

Mr. MAURSTAD. Yes, ma'am.

Ms. WATERS. Next month? This month? Next month?

Mr. MAURSTAD. Hopefully. I will work——

Ms. WATERS. Before December?

Mr. MAURSTAD. Yes, ma'am.

Ms. WATERS. Some time in November. Okay, we will look forward to that.

Mr. MAURSTAD. I will do my best.

Ms. WATERS. All right. There are some questions about the competency of some of the people that work for the Agency. And there is some information that I received about an adjuster training session, all these problems about—questions about the adjusters.

A training session that took place in Mississippi shortly after Katrina, and according to a Mr. Jackson, many of the prospective adjusters had never adjusted a claim of any type, and that the CSC trainer provided the test answers to more than 500 adjusters, and he believed that these untrained adjusters were being used, unleashed on unsuspecting Katrina and Rita victims. How do you respond to that?

Mr. MAURSTAD. I am not aware of that. We will certainly check into that. I would say to you that if there are independent adjusters, they have to be certified with the program for 4 years. If—we certainly have a provision where if a less experienced adjuster is needed because of the sheer volume of claims that we're looking at, that they have to work with one of our certified adjusters and, in essence, in a buddy system, so to speak, apprentice system.

And so there aren't any adjusters out there that have never worked flood insurance claims that have the authority to settle the claim. They would be working with one of the certified adjusters.

Now the adjusters that work for the companies that we primarily write the policies—that write the policies on behalf of the program, 95 percent of the policies are written by the write-your-own companies. They use their adjusters, and they train those adjusters, and they provide the assertion to us as a part of their arrangement with the program that those adjusters are trained.

But your specifics about somebody providing answers to test questions, I will have to look into. That's not my understanding. I don't have a firsthand understanding of that.

I did attend adjuster training sessions right after Katrina hit in Alabama and Mississippi and Louisiana, and I didn't witness any of that.

Ms. WATERS. What is the Jones Insurance Agency?

Mr. MAURSTAD. The Jones Insurance Agency that I am familiar with is located back in Nebraska. It's an independent insurance agency that operates in a few of the communities in Nebraska. I am sure there are a number of other Jones Insurance Agencies throughout the country.

Ms. WATERS. Is there one that is doing business as Maurstad Insurance Services?

Mr. MAURSTAD. That agency purchased the agency that I was a corporate officer of back in 2003, I believe.

Ms. WATERS. Are you a principal, a beneficiary in any way, of the Jones Insurance Agency at this time?

Mr. MAURSTAD. No. No, I am not.

Ms. WATERS. When did you sever your relationship with them?

Mr. MAURSTAD. I believe it was March 1, 2003. I can provide—if that's not correct, I will correct the record.

Ms. WATERS. Okay. Would you say that for me, again? March?

Mr. MAURSTAD. First of 2003. The agreement, I believe, was effective, actually, you know, January 1, 2003.

Ms. WATERS. What was the period of overlap in your service, your job, and the overlap with your——

Mr. MAURSTAD. As acting Federal insurance administrator, none.

Ms. WATERS. Give me the dates from the——

Mr. MAURSTAD. March 1, 2003. I was appointed acting Federal insurance administrator, I believe, June 25, 2004.

Ms. WATERS. Do you have any interest or participation in any other insurance-related business or entity at this time?

Mr. MAURSTAD. No, I do not.

Ms. WATERS. Well, I have a lot of questions here that relate to conflict of interest, and I don't want to just simply put you on the spot, because these are very serious questions. But you should be aware that there are a number of allegations and inquiries that are being made about past conflicts of interest, potential conflicts of interest, even to a point where you were licensed to serve as a broker.

So what I am going to do is I am going to set up some time with you to talk this over with you first and go through these questions so that you will have an opportunity to tell me what you know about these issues. And then we will see what happens from——

Mr. MAURSTAD. Yes. And I have provided this information to the ethics officer of the department. I have filed all the necessary financial disclosures as required.

Ms. WATERS. Okay.

Mr. MAURSTAD. I would be pleased to be able to sit down with you as well.

Ms. WATERS. Okay, thank you. We will do that. My time up?

Mr. PEARCE. Yes.

Ms. WATERS. Thank you very much.

Mr. PEARCE. There will be a second round if the gentlelady would like to take that.

Ms. WATERS. All right.

Mr. PEARCE. I think my first question would be that, Mr. Maurstad, I understand that you said we could sustain about $1 billion repayment, and the rest of it really should not be in the form of a loan. Is that more or less correct?

Mr. MAURSTAD. Yes, sir.

Mr. PEARCE. In your initial opening statement, you had talked about $1.5 billion to $3.5 billion has already been authorized, and another $5 billion would be authorized. Now, it was my understanding you were talking in terms of a loan at that point.

Mr. MAURSTAD. Yes, sir.

Mr. PEARCE. Why would we be—why would FEMA be requesting a loan when you don't have capability to repay anything exceeding $1 billion. Is that—shouldn't we just get the terminology out on the table right now?

Mr. MAURSTAD. The reason that we are requesting the additional loan authority is so that we can work with the committee and work with others in developing a program to—recommendations to strengthen the program when that—the ultimate decision that you're talking about would be made.

Mr. PEARCE. And what recommendations to strengthen the program involve—I mean, just basically financially, what recommendations are you going to make? Are there going to be premium increases for the affected areas? What?

Mr. MAURSTAD. Well, premium—there would not be premium increases for just the affected areas because the same rates are charged throughout the country based on the risk associated with a particular zone on the flood map. So more isn't charged——

Mr. PEARCE. I understand.

Mr. MAURSTAD. Okay.

Mr. PEARCE. Just premium increases across the board, then?

Mr. MAURSTAD. Certainly. We increased premiums last year.

Mr. PEARCE. How much did premiums go up last——

Mr. MAURSTAD. Those policies that are at less then risk, about 8 percent. The actuarial-rated policies that make up about 75 percent of the program, at about—my memory is between 2 and 3 percent. I can provide that, those specific increases, to you.

Mr. PEARCE. What about the repetitive losses that Mr. Jenkins mentioned? You have got 22,000 repetitive losses. I was watching a guy on TV one night saying that he had rebuilt two or three times and collected every time. Do you have any idea that you're going to begin to curtail those practices of paying repetitive losses?

Mr. MAURSTAD. We were given authority in 1994 and started the flood mitigation assistance program that was targeted at repetitive loss properties that was funded from part of the fees that were generated from the policies.

You know, last year we had about $20 million go towards that effort trying to address repetitive loss property——

Mr. PEARCE. How are we trying to address those?

Mr. MAURSTAD. Excuse me?

Mr. PEARCE. How are we trying to address them?

Mr. MAURSTAD. We either relocate or elevate the structures above the base flood elevation are the two primary ways that that is done.

And, of course, the—in the reauthorization in 2004 that included a provision to address severe repetitive loss properties—and, you know, we're pleased that with the signing of the Department of Homeland Securities budget a couple of days ago—we will now have the ability to transfer funds from the National Flood Insurance Fund to support the beginning of the severe repetitive loss property, as directed by the authorization——

Mr. PEARCE. You're not going to stop—you won't cease paying claims on repetitive properties? You will actually buy them out and physically move them, is that correct?

Mr. MAURSTAD. In the previous policy it was on a willing buyer/ willing seller basis that you provide a mitigation opportunity to a property owner and provide grant assistance to do that. We have two other programs——

Mr. PEARCE. Well, I think if we took a—did you take a look at some of the people? I mean, I suspect if I go back and explain to my constituents that we are paying—I think if we took a balance sheet of some of the people that we're buying their properties, and the number of times they have received compensation for those properties, I suspect I would not have a good time explaining to people in my district.

Our average income is about $21,000, $22,000 a year, and we are paying those repetitive losses to people, I suspect, with bank accounts larger than net worths of people in my district. I really question that whole process.

You have got—you have 40 full-time employees, 170 contract employees. How many people is it going to take to administer Hurricane Katrina by itself?

Mr. MAURSTAD. Well, one of the benefits of the way the program is structured—and again, that we rely on the 96 write-your-own companies to administer the program—is primarily their resources that are being used to handle the claims that are going to—that are outlined in the hand-outs that I provided you.

And so, although this is certainly beyond what a normal event would be, right now we have set up processes by which companies would be able to streamline some of the claims handling for those losses that are going to clearly exceed policy limits.

So we are working with the write-your-own industry to handle these claims as quickly and as fairly as possible. But the benefit, again, of the system—to get directly to your question—is we utilize the private insurance industry to deal with the magnitude of this event.

Mr. PEARCE. And I realize my time has expired, but just to follow up, is that, the cost for that use of the private insurance industry to administer, is that calculated into the cost?

Mr. MAURSTAD. Yes. Some of it is, sir, yes.

Mr. PEARCE. Ms. Waters, do you have additional questions?

Ms. WATERS. Well, you know, I am so concerned about all of these losses, and all of these citizens who will be placed in the position of trying to recover, trying to get insurance companies to pay, trying to get you to compensate them fairly.

And we have had so many complaints, and people are in the understanding, often times, that they are to be made whole, that the adjusters, you know, are not doing the work in a way that respects and recognizes their tremendous losses.

Now I am looking at this GAO report, and it said that FEMA has not yet fully implemented provisions of the Flood Insurance Reform Act 2004 requiring that the Agency provide policy holders with "a flood insurance claims handbook that meets statutory requirements to establish a regulatory appeals process," on and on and on, and that the deadline was December 30, 2004. What's with this?

Mr. MAURSTAD. There are some aspects of the reauthorization that we are—have not fully completed to this point. But as my written testimony indicates, beginning back in September, we are, in fact, providing the claims handbook to policy holders. We are in the process of the companies providing the summary of coverage to the policy holders as those policies are now beginning to be reviewed—or renewed.

So there are certain—the agent training component of the reauthorization, we have completed that, working as directed with the insurance commissioners across the country. So there are certain parts of the reauthorization that we have complied with and completed. There are other parts that we are in various stages of completing. We are working very aggressively at getting it all done.

Ms. WATERS. That's a real problem.

Mr. MAURSTAD. And if I could——

Ms. WATERS. Let me just tell you—and I think you know this—one of the greatest complaints that we are going to hear from the victims of Katrina and Rita is that they are not being treated fairly, that the adjusters are not treating them fairly.

So we are going to hear a lot of this. And we just hope that you can do something that will demonstrate that you are bending over backwards to treat these people fairly. I mean, they have gone through an awful lot.

Mr. MAURSTAD. Yes——

Ms. WATERS. Having said that, this handbook and information that helps to educate people and helps to help them to walk through these processes and these procedures is so very important. And that should not be underestimated. And I would like to see this fully implemented.

Mr. MAURSTAD. Yes, ma'am. We agree with you. And we wanted—and part of the delay, quite frankly, was working with the write-your-own companies, working with the agent groups, to make sure that the tools that we develop have the effectiveness that you're talking about.

So we work with them and consult with them to make sure that we do that. We agree that the better information we can provide to policy holders, the more easily they are going to understand the process and be able to have their claims handled fairly. We have——

Ms. WATERS. Do you think we should set up a program for the payment of premiums that will protect beyond $250,000, if people are willing to pay a little more?

Mr. MAURSTAD. We certainly—that figure has not been changed since 1994. We certainly need to look at——

Ms. WATERS. Have you recommended——

Mr. MAURSTAD. We would certainly need to look at, as we try to move forward on how we can strengthen the program, whether the fund can support that increase in limit of insurance. It certainly is on the table and certainly needs—and we are reviewing it.

Ms. WATERS. So—but you have not made a recommendation to that effect anyplace?

Mr. MAURSTAD. No, I have not.

Ms. WATERS. But this would be with an increase in premiums for those who are willing to pay?

Mr. MAURSTAD. There will certainly be——

Ms. WATERS. Can afford to pay? Who have properties that are in excess of $250,000? You think that's a legitimate way to deal with coverage of some of these properties?

Mr. MAURSTAD. I certainly think it's legitimate and certainly think that it's one of the things that we need to look at as we work together to try to strengthen the program if that, in fact, is——

Ms. WATERS. What's taking you so long? You didn't just start thinking about this today.

Mr. MAURSTAD. No. Part of the reason—I started, actually thinking about it a year ago, after some of our conversations and after reviewing some of the complaints that had been registered before.

But at that time, we were on the heels of the four hurricanes that we were affected by in 2004, causing the greatest number of claims in the history of the program, and the fund was in a borrowing position. And so to increase the limit of insurance at that point in time, it seemed to be prudent to wait and see as we continued to look at that. So it's on the table.

Another—what you're getting at is another concern of mine in that we need to continue to educate people and make people aware of, and that's insuring the value. Many times, when people do buy a flood insurance policy, they only buy it for a minimum amount. And then, when they have a devastating loss, they again don't have the necessary insurance proceeds to help them rebuild. So we need to do a better job of getting the 4.7 million policy holders that we have now to insure to value, similar to what they do on their normal homeowner policy.

Ms. WATERS. Well, what's taking you so long to have gotten that job done?

Mr. MAURSTAD. Well, we are working very aggressively. We have a public awareness campaign that we have shared with you before, floodsmart.gov. We have a national campaign we targeted to areas that have the greatest losses to try to make sure people understand their flood risk, encourage them to contact their local agent and buy a policy, provide the necessary information to them through our floodsmart.gov website——

Ms. WATERS. Okay, that's good. What about mapping? What have you done about that?

Mr. MAURSTAD. Mapping, we are working very aggressively, again, with our stakeholders. My programs all deal with working with States and local communities, associations like the Association of State Floodplain Managers, and we are working with them in implementing the flood map modernization. We are about—we are starting our, I think, fourth year of that 5-year program. We are on track.

But it takes time to develop maps, from an engineering point of view, working with the corps, working with private engineers. But then also, it takes time once we deliver those maps on a preliminary basis to the communities for them to have the public hearings necessary and to formally adopt those maps.

So the process is one that is 2 to 3 years in time. That's the way it is designed to be for the necessary public protections.

Ms. WATERS. Finally, do you support Mr. Taylor's bill for dealing with those people who have no flood insurance?

Mr. MAURSTAD. No. I do not.

Ms. WATERS. Why not?

Mr. MAURSTAD. Well, I think that it would provide a disincentive for people to purchase flood insurance. There is already a perception out there that one of the reasons why—I am told, when people are asked why they don't have a flood insurance policy—is one, they think that—they erroneously believe that it is covered under their homeowner's policy, but second, there is a perception that the Federal Government will come in at the time of a disaster, and——

Ms. WATERS. So what should happen to these people?

Mr. MAURSTAD.—provide them assistance. And it does not——

Ms. WATERS. What should happen?

Mr. MAURSTAD.—encourage people to do the right thing and buy——

Ms. WATERS. What should happen to these people who—this great disaster?

Mr. MAURSTAD. I think that there are a number of efforts, not only within the Department, but within the Federal Government and within the private sector to try to develop the best way to meet those unmet needs.

Ms. WATERS. No, we're not talking about meet unmet needs; we're talking about people who have lost everything they have, their home, everything they have.

Mr. MAURSTAD. I have seen it. Yes, I have seen it. And maybe I didn't phrase my answer very well. What I am getting at is that beyond this program that is designed to provide payment of insurance claims for people that had insurance policies, there are many other efforts underway to try to help those people——

Ms. WATERS. Such as?

Mr. MAURSTAD. Well, the individual assistance programs in the disaster support——

Ms. WATERS. Such as?

Mr. MAURSTAD. The Individual Assistance Program, rental assistance, that there is actually—part of that program is called "Unmet Needs." Temporary housing——

Ms. WATERS. Okay, see, it's all——

Mr. PEARCE. The gentlelady's time is expired.

Ms. WATERS.—talk in generalities about other programs, et cetera, but let me just say this, Mr. Chairman, and I am finished.

You have a lot of excuses, not only about mapping, about not making recommendations to the Congress of the United States about how to expand the program, excuses about why we have not done the education job you further exacerbate by telling me that people don't understand their own homeowner policies and think that they are covered, and because they are stupid and they are ignorant, that they should have to suffer, you know, the consequences.

Please, try and think about this differently. Try and think about what it means to a family to lose that home. I mean, that is the American dream. That is everything. And there may be—even though I have heard some discussion here today about how do we meet all of the needs and whether or not we are doing it for people with earthquake—there comes a time when the disaster is so catastrophic, it is so huge, that we need to do something special.

And we have got to be particularly sensitive at a time like this. And I want you to think about how you can strengthen our ability to provide protection in ways that people really understand it. And in this case, with Katrina, Rita, et cetera, how we do something extraordinary.

Thank you very much. And I appreciate that, Mr. Chairman.

Mr. PEARCE. The gentlelady's time has expired. The gentleman from Oregon, Mr. Blumenauer, is recognized.

Mr. BLUMENAUER. Thank you. And I do appreciate the subcommittee's courtesy in permitting me to join in this effort. I have been shuttling back from—with another committee I am on that's looking, actually, at some of the same things.

Mr. PEARCE. And the chair is about to have to do that, also.

Mr. BLUMENAUER. I will be very brief. I would like to ask about the nature of the report on the value of mitigation that was required, I think, in the HUD appropriations bill of 2003. My understanding is that you contracted with somebody; the report is done; you have reviewed it; it has been forwarded off to Homeland Security someplace. Do you have a sense of when this report is going to be released?

It seems to me that if there was ever a time when it would be useful for Congress to be able to understand the value of mitigation, it would be as we are looking at these sensitive issues. When can we get this report?

Mr. MAURSTAD. Sir, I have seen a draft of the report. We have seen—but the actual report has not been formally transferred to the Department or to the mitigation division.

It's my understanding that that's going to happen any day now. I agree with you on the timeliness of the findings of that report. And—but that is, as I understand it, the current status.

We have worked with the multi-hazard mitigation council that—the briefing that I received a number of months ago, as they were winding down the report, the scientists that they used on the report, I think it's going to be a very valuable tool, and I also am anxiously waiting for that report to be provided to us.

Mr. BLUMENAUER. Well, it would be helpful if we could pin this down and get a specific answer about where this is. I was told that it had been cleared by FEMA and had been sent off to the Department of Homeland——

Mr. MAURSTAD. Sir, we have seen a draft of it, and I am waiting for the multi-hazard mitigation council to provide me with the formal report. And it was my understanding last week that it was on its way.

Mr. BLUMENAUER. Good to know. I am unclear about the progress on the implementation on the regulations for the Flood Insurance Reform Act.

What are some of the critical issues that have been highlighted by your consultation of the States and communities, and when are we going to see that promulgated?

Mr. MAURSTAD. What—I guess I am not sure what—are you talking about the agent training component that you asked us——

Mr. BLUMENAUER. The regulations that would be attended to the flood insurance reform.

Mr. MAURSTAD. Are you talking about the severe repetitive loss pilot program?

Mr. BLUMENAUER. There are regulations with that, and I thought there were some other regulations that had not yet been promulgated.

Mr. MAURSTAD. Well, we just received the ability to transfer the funds from the National Flood Insurance Fund to provide the resources to start the severe repetitive loss program.

We held that consultation meeting, actually, late last year, as required by the legislation, and are now in the—beginning with the authority that happened a couple of days ago, with beginning the rulemaking process.

Mr. BLUMENAUER. And when do you think the rules will be finished?

Mr. MAURSTAD. Well, I am hopeful——

Mr. BLUMENAUER. This is a conversation you and I had 6 months ago.

Mr. MAURSTAD. Well, we didn't have the authority six months ago to be able to begin the pilot program. We now have that authority. I am hopeful that if we get some of our—when we get some of our staff back from the field that are still helping the respond and recover to Katrina and Rita, that rulemaking process as we both know it, some time in the March/April time frame of next year.

Mr. BLUMENAUER. I had submitted a series of questions after our April hearing and resubmitted them in writing in September. To the best of my knowledge, we haven't yet—and I understand things have been going on——

Mr. MAURSTAD. That's correct, and I—as I indicated to Ms. Waters, I made a commitment to her to work with the other parts of our department to get those answers back to you some time next month.

Mr. BLUMENAUER. I would just conclude—one thing that would be useful to have, because we have been having conversations in the past—I appreciate your courtesy—but by the nature of the business that FEMA is involved with, there is always something going on. You would wish there wouldn't be, but the reason you're there is because we have emergencies. And we had four hurricanes last fall; we've got Katrina; we've got a whole range of things.

I have been working with FEMA for the last 5 years to try and get resources to the Agency, new tools, money, and authorization so that it's easier for you to do the job. And I have appreciated the professionalism with a whole host of folks who have given us back information as we have tried to craft legislative responses.

What would be helpful would be to have a candid response from the Agency about what you need to be able to deliver what's in the pipeline, what we have been trying to do. I don't like being in a sort of a give-and-take situation because I have tried to be on your side for 5 years. And I see some of our old friends in the back of the room who have been there and have been constructive.

But what would be very helpful for some of us who have been trying to be constructive partners with FEMA is to understand what it is that we can give you to clarify, to provide resources, and to move us forward.

We are going to be spending—I think we're spending $14 million an hour, last I calculated. I mean, it's—after a while it's real money. But number of things that we have talked with you about here, and that the committee is looking at, are not that expensive in the overall scheme of things. But they will make a huge difference on saving long-term costs, helping people get out of harm's way, and helping us get ahead of the curve, rather than you folks scrambling to catch up.

And so my specific request is to have some of your certified smart people who have been through this before and given what's happened informed by your year or so in this" squirrel cage," get some specifics so that we can go to bat with our authorizing committees and our appropriating committees, to make sure that whatever it is to clear up ambiguity or to provide resources happens, so we're not in a situation like you're telling me, that something we passed last year we're going to talk about maybe promulgating regulations next year.

I am interested in ways that we can get ahead of the curve, and I look forward to working with the committee and the committee's staff on these recommendations so that we can—so we're not going to rehash this. And I offer it from the perspective of somebody who has been trying to work with you folks for 5 years.

Mr. MAURSTAD. Well, sir, we—as I have indicated before, we appreciate your support. My Member of Congress, of course, worked very closely with you—now retired Congressman Bereuter. I have had conversations with him. We appreciate your support.

The rep loss pilot program, now that we have that authority, provides some assistance for staff in that area that we didn't have the capability of before, but we will certainly look at your request and have that continued discussion with you.

Mr. BLUMENAUER. Thank you. Mr. Chairman, thank you for your courtesy——

Mr. PEARCE. I thank the gentleman from Oregon. And I just have two last questions, and I appreciate your indulgence. You have been very gracious with your time, and you got caught in a vote, and the first hearing lasted somewhat longer.

Mr. Jenkins, I am going to ask you last—but you're going to be thinking about it based on your previous work—of the $22 billion or $23 billion in losses that are declared on this page, how much problem do you think—how many dollars problems would you think would be involved in there based on the lack of oversight and people overestimating? So that will be the wrap-up question.

Mr. Maurstad, you indicated legitimacy to upping the ceiling, the cap. If we change from $250,000, say, to $500,000—that's a nice, round number; it's twice. If that were the case, how much would your columns change by here, and how much would you have changed in Katrina?

And then I suspect if you talked about raising the caps—which you said the Agency has talked about—you have gone back and plugged in to the losses for 2004, that was $2.28 billion—how much would those losses have gone up through the increased caps, and how much more exposure do we have here? If you can give those——

Mr. MAURSTAD. Well, I would try—your—an answer to your question would require a number of assumptions based on how many people that currently have the maximum amount of insurance, $250,000, would pay the additional premium to go to a higher level. That would be the first assumption that comes to my head that would have to be made.

But most importantly, what we would do is we would go back and actuarially determine what the additional premium amounts would need to be, given the higher limit of insurance that we would be making a commitment to paying for, if there were a loss, and determining what those appropriate premium levels should be.

And then, you would—we would have to determine—and it would be most accurate after the fact—how many people decided to increase their limit of insurance, pay that additional premium that would then provide the additional resources to pay claims.

Mr. PEARCE. Am I to understand, then, that you have not put in any projections? As a business owner, I would tell you how I would approach it. I would approach it to the maximum risk. That is, the maximum number people take it as possible, and we suffer the maximum number of losses. That is, this loss sheet extended to the maximum. And then you would project the increase of premiums.

And am I to understand that even though you are suggesting that we want to go up on the caps, you haven't figured out what it's going to actually cost the taxpayer in New Mexico?

Mr. MAURSTAD. Well, again sir, as also a former small business owner, I would look at things in a certain fashion. And I know, from my experience, that the actuaries are going to look at it in a whole other fashion to make sure that what's being done is done——

Mr. PEARCE. I understand that. We're just talking about a business model.

Mr. MAURSTAD. But——

Mr. PEARCE. If I'm going to come to the Congress and suggest that we up the caps, I think I would be prepared to say, "If we did that and if everybody had upped their premiums and upped their purchases, the losses, instead of $22 billion, would be $33 billion," or something. I just think that's a fair question for us to ask, and a business-like question to ask, so that we know the stakes of going up on our premiums.

And, likewise, because this is an extraordinarily high loss year, it would be very, very pragmatic to scoot back to 2004, which was the period of greatest loss, but at 1/10th the level and say, you know, "We are not going to always get these big years, but even in this bad year, this 1/10th year, here is what we would have expected."

Mr. MAURSTAD. That modeling would go on. And again, we would base it as—absent any other substantive program changes—based on an average loss year, as to the ability to generate the necessary premium from the policy holders to pay the claims that come in during that year.

Mr. PEARCE. I understand that. My point is that you said that you saw certain legitimacy to the idea, that you all had talked about it internally. And to talk about it internally without measuring the possible consequences, to me, is upside down, that as we are talking about the legitimacy, we should be talking about the consequences.

Mr. Jenkins, would you like to wrap up? We really do need to finish this.

Mr. JENKINS. You asked about the potential extra cost.

Mr. PEARCE. Yes.

Mr. JENKINS. I would say that, basically, if you take the Isabel model and assume that it, with some adjustment, sort of applies to this, you had roughly 10 percent of people who had an opportunity to appeal their claim did appeal their claim. And then, of those people, half got more money, and they got about 10 percent more than their average claim for various reasons.

So you could say, based on that model, that whatever this estimate is, it's probably not unreasonable to assume it's about 10 percent higher. Particularly if you have an appeals process.

The thing that—the mitigating factor in that compared to Isabel is that a lot of these people whose homes have been completely wiped out are going to get the maximum that their policy pays, so you're not going to have some of the issues, in terms of what the repair costs are, and the schedule of costs that ought to be used, and that kind of thing, because it's not an issue for those particular claims.

Mr. PEARCE. Using your knowledge of the system, did you have a chance to review the charts——

Mr. JENKINS. No, we have not seen those.

Mr. PEARCE. Just going to assume severity and the bulk of the losses are going to occur in Jefferson Parish, where there is a loss of $75,000 per unit projected, and 73,000 homes, a loss in Orleans Parish, of 100,000.

Using your estimates, would those severity calculations be fairly accurate, or is it just too far out of your realm to guess?

Mr. JENKINS. Just—we would really have to look at it. I mean——

Mr. PEARCE. Okay, all right.

Mr. JENKINS. Just let me give you additional information.

Mr. PEARCE. Yes.

Mr. JENKINS. We have some data, this October 13th data that we got, and we know it has to have an error in it. The average claim that that data shows for Louisiana is $663,000. That's pretty unlikely that that's the actual average amount being paid.

Mr. PEARCE. Right. Thank you both, and again, Mr. Maurstad, these are very difficult days, very difficult times, and the questions that we have to wrestle with are tremendous. But the ones that you have to see firsthand are even worse. So I thank you for your service and thank your Agency.

The chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, this hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place the responses in the record.

[No response.]

Mr. PEARCE. Hearing none, this hearing is adjourned.

[Whereupon, at 1:15 p.m., the subcommittee was adjourned.]

APPENDIX

October 20, 2005

Statement of Sue Kelly

Thank you Chairman Ney for holding this important hearing and inviting me to sit with the subcommittee.

On April 14 and July 12th of this year, before Hurricanes Katrina and Rita, this subcommittee held hearings on the flood insurance program that exposed major problems at FEMA, especially with its customer service. Too many of the citizens and homeowners of my district in New York did not hear from FEMA until far too late during devastating flooding this spring in Port Jervis and other communities of Orange County. I was told point-blank by the witness before us that FEMA was unwilling to engage in comprehensive outreach to make sure all valid claims under the flood insurance program were filed.

Today, the whole word has discovered the failures at FEMA Chairman Ney worked to uncover. FEMA has a new director who is committed to making his agency work better at both flood insurance and emergency assistance. I am concerned, however, that the communities that depend on the flood insurance program, such as my district, are not given the priority they need in handling claims and knowing their rights. My concern rose when I read GAO's testimony that FEMA is in violation of the law, specifically the Flood Insurance Reform Act of 2004, and has yet to issue simple new forms to customers and regulators.

FEMA must honor its commitment to our constituents by ensuring all eligible claims are filed. Earlier this year we learned that outreach by FEMA expanded the number of claims filed in Florida after Hurricane Isabel increased paid claims by 2 percent. Victims of every storm deserve 100 percent restitution, not 98 percent.

FEMA must also make sure that incentives for mitigation, program participation and claims are separated so that no official is conflicted between seeing more customers are served, seeing more homeowners paid, and costs to the program. Flood Insurance program officials say they are overworked from the more than 7 major hurricanes and storms in the last two seasons, and they are right. But when things aren't working we change them. The National Flood Insurance Program administration must be compartmentalized so that outreach, mitigation, and actuarial work is not crippled by operational responses to storms.

According to FEMA's own documents 154 workers are at NFIP HQ, but they are divided into 7 branches and 16 sections and offices. The result is many small offices that become swamped in an emergency. NFIP must be restructured around simpler stovepipes that can focus on their tasks without being overwhelmed. I stand ready to work with members on both sides on legislation to strengthen NFIP outreach and planning to better serve customers and communities.

Citizens along the Delaware and Hudson in my state know that flood insurance is needed to protect their homes and property. Those who elected not to buy flood insurance at low, government-subsidized premiums chose to keep that money and insure themselves. Policy holders should not be forced to subsidize those who failed to share the risk of flooding with them. I strongly oppose any attempt to extend retroactive eligibility for flood insurance to areas that have suffered losses, and I condemn the efforts of the Mississippi Attorney General to use the suffering of his constituents as an excuse to extort money from insurance companies that did not insure against floods.

I look forward to hearing from our witnesses.

WRITTEN STATEMENT

REPRESENTATIVE JO ANN DAVIS

HOUSE OF REPRESENTATIVES HOUSING AND COMMUNITY OPPORTUNITY SUBCOMMITTEE

MANAGEMENT AND OVERSIGHT OF THE NATIONAL FLOOD INSURANCE PROGRAM

OCTOBER 20, 2005

Mr. Chairman, thank you for holding this hearing and thank you for allowing me to be here today.

In April of this year I was here along with several of my constituents talking about the National Flood Insurance Program and the problems experienced following Hurricane Isabel in 2003. Two of my constituents explained to this sub-committee their experiences with mismanaged claims and misled policies. I've repeatedly contacted the Department of Justice, Department of Homeland Security and even the White House outlining these concerns.

But we are back, facing many of the same problems outlined in April. This time things are much worse. Unfortunately, it took two devastating hurricanes for the failings of FEMA to finally get everybody's attention, not just unfortunate flood victims.

Hurricane Isabel highlighted many problems and shortcomings within the National Flood Insurance Program. I still have constituents living in FEMA trailers, trying to rebuild their lives two years after the storm. I've seen examples of mismanaged claims and misled policy holders. FEMA has failed to meet many requirements contained in the Flood Insurance Reform Act. It has failed to

- establish insurance agent and adjuster education and training requirements.
- FEMA has failed to explain coverage and the claims process to policyholders.

- It has failed to establish an appeals process for claimants.

Members of this Committee and Members of the House expected FEMA to act when Congress passed the Flood Insurance Reform Act of 2004.

I'm afraid FEMA's failure to act has resulted in Isabel like failures on a grand scale. 20,000 claims followed Isabel; a hundred thousand will likely follow Katrina. It's past time that FEMA implement the provisions of the Flood Insurance Reform Act and if FEMA isn't going to do it, I hope my colleagues will agree that Congress needs to take further legislative action.

Thank you again, Mr. Chairman, for your continued concern about this issue. I appreciate everything you and your committee are doing to address these problems.

Congressman Michael G. Fitzpatrick

Subcommittee on Housing and Community Opportunity
"Management and Oversight of the National Flood Insurance Program"
October 20, 2005

In September of 2004 and April of 2005, the families of the 8th Congressional district of Pennsylvania suffered two incredibly destructive floods. As a result, the district suffered millions of dollars damage. More importantly, the lives of many families were turned upside down; they were forced out of their homes and their businesses.

As a former Bucks County Commissioner and now as a Member of Congress, I have continued to hear from my constituents that they have received pennies on the dollar for their flood claims. The administrative problems plaguing the National Flood Insurance Program (NFIP), like the claim processing and inconsistencies in interpretations about the standard used to determine claim amounts, have long been documented by this Subcommittee prior to Hurricane Katrina.

According to the GAO, FEMA is not living up to its management and oversight duties. "...FEMA cannot determine the overall accuracy of claims settled for specific flood events or access the overall performance of insurance companies and their adjusters in fulfilling responsibilities – actions that are necessary for FEMA to have reasonable assurance that program objectives are being achieved...." Equally as concerning, FEMA has not fully employed the provisions in the Flood Insurance Reform Act even though the statutory deadline was December 30, 2004.

I want to know why FEMA is inadequate in running NFIP. Is this a question of ability or funding? I would like FEMA to answer the questions I submitted months ago and I would like to receive the documents I requested from FEMA.

Chairman Ney, thank you for your continued leadership on this very important issue. These flood victims need to rebuild their homes and their lives.

United States Government Accountability Office

GAO

Chairman, Subcommittee on Housing and Community Opportunity, Committee on Financial Services, U.S. House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EST
Thursday, October 20, 2005

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

GAO
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GAO-06-183T

DRAFT

October 2005

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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

FEDERAL EMERGENCY MANAGEMENT AGENCY

Oversight and Management of the National Flood Insurance Program

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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Report to Congressional Committees

October 2005

FEDERAL EMERGENCY MANAGEMENT AGENCY

Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program

GAO

Accountability • Integrity • Reliability

GAO-06-119

October 2005

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Highlights

Highlights of GAO-06-119, a report to congressional committees

FEDERAL EMERGENCY MANAGEMENT AGENCY

Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program

Why GAO Did This Study

In the wake of Hurricane Isabel in 2003, GAO was mandated by the Flood Insurance Reform Act of 2004 to report on issues related to the National Flood Insurance Program (NFIP) and its oversight and management by the Federal Emergency Management Agency (FEMA). Private insurance companies sell NFIP policies and adjust claims, while a private program contractor helps FEMA administer the NFIP.

To address this mandate, this report assesses (1) the statutory and regulatory limitations on coverage for homeowners under the NFIP; (2) FEMA's role in monitoring and overseeing the NFIP; (3) FEMA's response to concerns regarding NFIP payments for Hurricane Isabel claims; and (4) the status of FEMA's implementation of provisions of the Flood Insurance Reform Act of 2004.

Although impacts from Hurricane Katrina were not part of the report's scope, GAO recognizes that this disaster presents the NFIP with unprecedented challenges.

What GAO Recommends

GAO is recommending 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 reviewed a draft of this report and expressed concerns about our findings related to NFIP program management.

www.gao.gov/cgi-bin/getrpt?GAO-06-119

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 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.

In the months after Hurricane Isabel, FEMA took steps intended to address concerns that arose from that flood event. In April 2004, FEMA established a task force to review claims settlements from Hurricane Isabel claimants. As a result of task force reviews, almost half of the 2,294 policyholders who sought a review received additional payments. The additional payment amount averaged $3,300 more than the original settlement—for a total average settlement of about $32,400 per claimant. In most cases, the additional funds were for repairing or replacing buildings or property not included in the initial adjuster's loss determination, or to cover additional material or labor costs.

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 NFIP 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.

Contents

Abbreviations

FEMA	Federal Emergency Management Agency
NFIP	National Flood Insurance Program
OMB	Office of Management and Budget
SFIP	Standard Flood Insurance Policy

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Accountability * Integrity * Reliability

United States Government Accountability Office
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October 18, 2005

The Honorable Richard Shelby
Chairman
The Honorable Paul Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Michael Oxley
Chairman
The Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives

Ninety percent of all natural disasters in the United States involve flooding. Although homeowner insurance policies typically cover damage and losses from fire or theft and often from wind-driven rain, they do not cover flood damage because private insurance companies are largely unwilling to bear the economic risks associated with the potentially catastrophic impact of flooding. To provide some insurance protection for flood victims, as well as incentives for communities to adopt and enforce floodplain management regulations to reduce future flood damage, Congress established the National Flood Insurance Program (NFIP) in 1968. NFIP coverage is available to owners and occupants of insurable property in flood-prone areas.[1] The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security is

[1] Our report focuses on homeowners' NFIP coverage; NFIP coverage is also available for other structures such as apartment buildings, schools, churches, businesses, cooperative associations, and condominium associations.

responsible for, among other things, oversight and management of the NFIP.[2]

To implement the NFIP, FEMA principally relies on private insurance companies that sell flood insurance policies and adjust claims from policyholders after floods occur. FEMA is assisted in its management and oversight functions by a program contractor. As of August 2005, the NFIP had about 4.6 million policyholders in about 20,000 communities. As of August 2005, the program had paid a total of about $14.6 billion in insurance claims financed primarily by policyholder premiums. Without the NFIP, the costs to repair damage covered by these claims would otherwise have been paid through taxpayer-funded disaster relief or by the flood victims themselves.

Policyholders' concerns regarding the processing and payments of NFIP claims after Hurricane Isabel in 2003 focused congressional attention on the program. Specifically, some policyholders cited inadequate payments for flood damages they incurred and a lack of clarity regarding their insurance policies and the procedures for filing and adjusting claims for flood damage.

The Flood Insurance Reform Act of 2004,[3] which mandated that FEMA implement new processes and requirements for selling NFIP policies and adjusting flood insurance claims, also mandated that we study and report on issues related to the processing of flood insurance claims and FEMA's oversight and management of the program. To address this mandate, this report assesses (1) the statutory and regulatory limitations on homeowners' coverage under the NFIP; (2) FEMA's role in monitoring and overseeing the NFIP; (3) FEMA's response to concerns regarding NFIP payments for claims related to Hurricane Isabel; and (4) the status of FEMA's implementation of provisions of the Flood Insurance Reform Act of 2004.

[2] 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 has retained its name and individual identity within the department. The Secretary of DHS has proposed a reorganization of DHS in which FEMA would report directly to the Secretary and Undersecretary of DHS.

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

As we finalized this report, the extent of the devastation from Hurricanes Katrina and Rita in August 2005 and September 2005 was not yet fully determined, as the nation struggled to respond to the immediate needs of populations of entire cities and towns for food, water, shelter, and basic health care. Although impacts from Hurricane Katrina and Rita were not part of our mandate for this report, clearly this disaster will challenge the NFIP with demands the program has never before faced in its more than 30-year history. Already, a record number of flood insurance claims have been filed in 2005, and Congress has increased the program's authority to borrow from the United States Treasury from $1.5 billion to $3.5 billion.

To determine the statutory and regulatory limitations on homeowners' coverage under the NFIP, we researched The National Flood Insurance Act of 1968, as amended,[4] its legislative history, and FEMA's implementing regulations, which include FEMA's "Standard Flood Insurance Policy" (SFIP). We also discussed the results of our analysis with officials of the DHS Office of General Counsel. To assess FEMA's NFIP monitoring and oversight role, we examined program requirements and reports and observed NFIP training programs for insurance agents and adjusters. We also observed a FEMA review of an insurance company's operations, and we analyzed reports of the results of all reviews of insurance operations and follow-up visits at insurance companies where FEMA identified critical errors over a 10-year period, from 1996 to April 2005—a total sample of 15 reports. We interviewed officials of FEMA and its program contractor about their oversight activities and discussed aspects of the process with private-sector insurance officials from four of the five largest insurance companies participating in the NFIP based on the number of claims filed in 2004. We also obtained documentation on how reviews of a sample of claims adjustments are done after flood events and talked with staff employed by FEMA's contractor about how they reinspect the work of private-sector adjusters who prepare flood damage estimates and how they select properties to visit for these reviews. We interviewed them because they had performed quality reinspections of claims adjustments for damage from Hurricane Isabel, as well as from hurricanes in Florida in 2004.

To determine FEMA's response to concerns about Hurricane Isabel claims payments, we discussed the actions FEMA took to address concerns of

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

Hurricane Isabel claimants with FEMA officials, and we reviewed a statistically valid sample of 100 files from claimants in Maryland, Virginia, and North Carolina who were dissatisfied with their initial claims settlements resulting from Hurricane Isabel and who had their claims reviewed by a special FEMA task force. We based our analysis of these claims on the information in the files we reviewed; we did not independently verify the accuracy of the information in the claims files. To test the overall reliability of the NFIP database, we reviewed a statistically valid sample of 250 claims for all flood events that occurred in 2003 and 2004. We conducted this reliability testing to assure ourselves that information from the NFIP database was sufficiently accurate for our reporting purposes. To determine the extent to which FEMA implemented provisions of the Flood Insurance Reform Act of 2004, we examined documentation of the agency's efforts and interviewed officials. We conducted our work from December 2004 through August 2005 in accordance with generally accepted government auditing standards. Our scope and methodology are discussed in greater detail in appendix I.

Results in Brief

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 of 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 may purchase; thus, homes that might sustain more than $250,000 in damage cannot be insured to their full replacement cost. In addition, NFIP policies cover only direct physical loss by or from flood. Therefore, losses resulting primarily from a preexisting structural weakness defect in a home or prior water damage, and losses resulting from events other than flood, such as windstorms or earth movements, are not covered by the NFIP. Moreover, a homeowner's personal property is covered, with certain limitations, only if the homeowner has separately purchased 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 represents the cost to replace damaged 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.

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. The operational reviews and follow-up visits to insurance companies that we analyzed 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. However, 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 meet our internal control standard that it have reasonable assurance that program objectives are being achieved and that its operations are effective and efficient.

In the months after Hurricane Isabel, FEMA took steps intended to uniquely address concerns that arose from that flood event. In April 2004, FEMA established a task force to review claims settlements from Hurricane Isabel claimants. This was the first time in the history of the NFIP that a formal claims review process was established. As a result of task force reviews, almost half of the 2,294 policyholders who sought a claims review received additional payments. The additional payment amount averaged $3,300 more than the original settlement—for a total average settlement of about $32,400 per claimant. In most cases, the additional funds were for repairing or replacing buildings or personal property not included in the initial adjuster's loss determination; or to cover additional material or labor costs. For example, in one instance the original adjuster had not included coverage for a kitchen countertop and a cable television outlet that the task force added to the claims settlement. In other claims, reviewers allowed higher prices for paint, dry wall, insulation, and other building materials than had been allowed in the initial loss report. An NFIP manager said that the original pricing was not an error in many cases, but that the costs of the materials had increased between the time of the initial loss and the final settlement offer. Among reasons that claims reviewed by the task force were closed with no additional payment were that the reviewer agreed with the original determination that (1) flood damage to parts of a basement were not covered and that (2) damage was not due to flood but to wind-driven rain.

As of September 2005, FEMA had not yet fully implemented provisions of the Flood Insurance Reform Act of 2004. The act requires FEMA to provide policyholders a flood insurance claims handbook and other new materials for explaining their coverage when they purchase and renew policies; to establish a regulatory appeals process for claimants; and to establish minimum education and training requirements for insurance agents who sell NFIP policies. The 6-month statutory deadline for implementing these changes was December 30, 2004. While FEMA advised us that it finalized statutorily required informational materials in September 2005, its flood insurance claims handbook does not yet fully comply with statutory requirements. The handbook contains information on anticipating, filing and appealing a claim, but does not include information regarding the appeals process that FEMA is statutorily required to establish through regulation. In its comments on our draft report, FEMA stated that it was offering claimants an informal appeals process pending the establishment of a regulatory process, and that the handbook describes this informal appeals process. However, by statute, the claims handbook must describe the regulatory process, which FEMA has yet to establish. 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. 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 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.

To strengthen and improve FEMA's monitoring and oversight of the NFIP, we are recommending that FEMA use a methodologically valid approach for sampling files selected for operational reviews and quality assurance claims reinspections. To help ensure that actions are taken in a timely manner to address legislative requirements established in the Flood Insurance Reform Act of 2004, we are recommending that FEMA establish documented plans with milestones for completing its efforts and hold NFIP officials accountable for implementing these plans.

In commenting on a draft of this report, FEMA expressed concerns about our findings related to NFIP program management and oversight. Specifically, FEMA was concerned that we did not directly address the issue of whether Congress intended the NFIP to restore flood-damaged properties to their pre-flood conditions. We believe we have addressed the issue consistent with our statutory mandate by explaining the statutory and regulatory provisions that affect both dollar ceilings and other coverage limitations. In other words, flood insurance policies can only restore victims to pre-flood conditions within, but not beyond, the dollar ceilings and other coverage limitations established by law and regulation. FEMA also questioned our characterization of its operational reviews and claims reinspection processes in the context of FEMA's overall financial and management control efforts. However, our focus was on overall NFIP program management and oversight, not on FEMA's fiduciary responsibilities or additional internal control measures. During our review, FEMA managers described the operational reviews and claims inspections as the primary methods FEMA used for monitoring and overseeing the NFIP.

FEMA also noted that its method of selecting its sample for operational reviews was more appropriate than the statisticall y random probability sample we recommended. We believe that, although FEMA's current 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

In addition, FEMA 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 remain valid. FEMA's comments are contained in appendix II. In addition, FEMA provided technical comments, which we incorporated into the report as appropriate.

Background

Nearly 20,000 communities across the United States and its territories participate in the NFIP by adopting and agreeing to enforce state and community floodplain management regulations to reduce future flood damage. In exchange, the NFIP makes federally backed flood insurance available to homeowners and other property owners in these communities. Homeowners with mortgages from federally regulated lenders on property in communities identified to be in special high-risk flood hazard areas are required to purchase flood insurance on their dwellings. Optional, lower-cost coverage is also available under the NFIP to protect homes in areas of low to moderate risk. To insure furniture and other personal property items against flood damage, homeowners must purchase separate NFIP personal property coverage. Although premium amounts vary according to the amount of coverage purchased and the location and characteristics of the property to be insured, the average yearly premium for a 1-year policy was $446, as of June 2005.

The National Flood Insurance Act of 1968[5] established the NFIP. Congress mandated that the NFIP was to be implemented "based on workable

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

methods of pooling risks, minimizing costs, and distributing burdens equitably among those who will be protected by flood insurance and the general public."[6] To make "flood insurance coverage available on reasonable terms and conditions to persons who have need for such protection,"[7] the NFIP strikes a balance between the scope of the coverage provided and the premium amounts required to provide that coverage. Coverage limitations arise from statute and regulation, including FEMA's standard flood insurance policy (SFIP), which is incorporated in regulation and issued to policyholders when they purchase flood insurance.

To the extent possible, the program is designed to pay operating expenses and flood insurance claims with premiums collected on flood insurance policies rather than by 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 certain structures 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.[8] FEMA has statutory authority to borrow funds from the Treasury to keep the NFIP solvent.[9] Following Hurricane Katrina in August 2005, legislation was enacted that increased FEMA's borrowing authority from a total of $1.5 billion to $3.5 billion through fiscal year 2008.[10] FEMA has exercised its borrowing authority four times in the last decade when losses exceeded available fund balances. For example, as of August 2005, FEMA had borrowed $300 million in 2005 to pay an estimated $1.8 billion on flood insurance claims resulting from the 2004 hurricane season. As it has done when it has borrowed in the past, FEMA intends to repay these funds with interest, according to agency officials, however, the officials had not yet estimated NFIP claims amounts anticipated for flood damage from Hurricane Katrina in August 2005.

[6] 42 U.S.C. 4001(d).

[7] *Id.* 4001(a)(4).

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

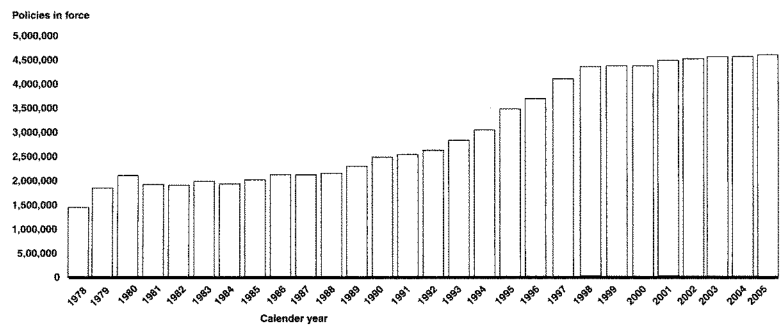
[9] See 42 U.S.C. 4016.

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

Participation in the NFIP and Claims Payments Have Grown

As shown in figure 1, the number of NFIP policies in force has grown steadily over the past 27 years to a total of about 4.6 million policies in force as of May 31, 2005.

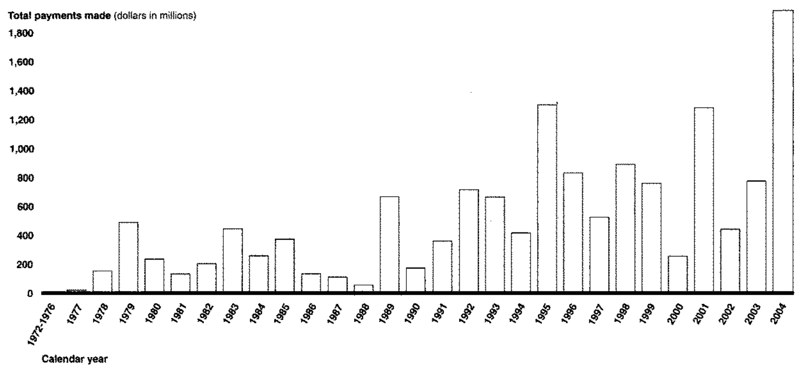
Figure 1: NFIP Policies in Force, 1978-2005



Source: FEMA.

As shown in figure 2, NFIP claims payments have varied widely by year over the life of the program depending on the number and severity of flood events; however, as the number of policies in force increased (see fig. 1), the claims payments have trended upward. Claims paid in 2004 were the highest amount in the history of the NFIP—more than $1.9 billion for all flood events.

Figure 2: Total NFIP Payments to Claimants, 1972-2004



Source: FEMA.

Tables 1 and 2 provide information on payments by flood event in 2003 and 2004. In 2003, the NFIP paid about $478 million on more than 21,000 claims from 5 named flood events and an additional $287 million on 15,232 claims filed for damage from unnamed floods. Of those claims, more than half resulted from damage from Hurricane Isabel in six states and Washington, D.C. Hurricane Isabel was a category 5 hurricane at its peak with sustained winds in excess of 165 miles per hour. It made landfall on September 18, 2003, near Drum Inlet, North Carolina, as a category 2 storm. As it traveled across Virginia, Maryland, and Pennsylvania, Isabel weakened to a tropical storm, but its heavy rains caused storm surge flooding.

Table 1: NFIP Claims Payments on Flood Events in 2003

Dollars in thousands

Flood event/state(s)	Number of paid losses	Amount paid
Hurricane Isabel (Delaware, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, and Washington, D.C.)	19,523	$455,869
Delaware flooding (Delaware)	10	64
Torrential rain (Puerto Rico)	261	1,366
Hurricane Claudette (Texas)	1,035	10,884
Tennessee flood (Tennessee)	309	9,759
Named flood event total	21,138	477,942
Unnamed flood total	15,232	287,317
Total	**36,370**	**$765,259**

Source: GAO analysis of FEMA data.

For 2004 flood events, as of April 30, 2005, the NFIP paid more than $1.9 billion on more than 52,785 NFIP claims from storms including Hurricanes Charley, Frances, Ivan, and Jeanne that caused major damage in Florida and other East Coast and Gulf Coast states.

Table 2: NFIP Claims Payments on Flood Events in 2004

Dollars in thousands

Flood event/state(s)	Number of paid losses	Amount paid
Kentucky Flood (Kentucky)	279	$5,717
Hurricane Alex (North Carolina)	249	2,436
Hurricane Charley (Florida and North Carolina)	2,434	46,369
Hurricane Frances (Florida)	4,737	139,866
Hurricane Ivan (Alabama, Florida, Georgia, Louisiana, Mississippi, Ohio, Pennsylvania, Virginia, and West Virginia)	25,558	1,233,964
Hurricane Jeanne (Florida and Puerto Rico)	3,994	78,355
Named flood event total	37,251	1,506,707
Unnamed flood total	15,534	442,678
Total	**52,785**	**$1,949,385**

Source: GAO analysis of FEMA data.

Private Insurers Sell Policies and Adjust NFIP Claims under FEMA Oversight and Management

The work of selling, servicing, and adjusting claims on NFIP policies is carried out by thousands of private-sector insurance agents and adjusters who work independently or are employed by insurance companies or their designated subcontractors. According to FEMA, about 95 percent of the NFIP policies in force are written by insurance agents who represent 95 private insurance companies that issue policies and adjust flood claims in their own names.[11] The companies, called write-your-own companies, receive an expense allowance from FEMA of about one-third of the premium amounts for their services and are required to remit premium income in excess of this allowance to the National Flood Insurance Fund.[12] The write-your-own companies also receive a percentage fee—about 3.3 percent of the incurred loss—for adjusting and settling claims. The insurance companies share the FEMA expense allowance and fee for claims settlements with insurance agents who sell and service the policies, a vendor, or subcontractor, if the company has subcontracted with one to handle all or part of its flood insurance business, and flood claims adjusters.[13]

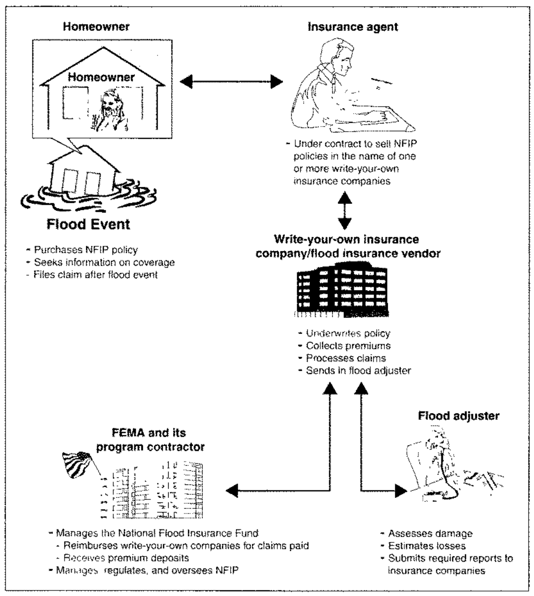
Figure 3 shows the key participants in the process: a homeowner; an insurance agent, an insurance company, and, in many cases, a flood insurance vendor, or subcontractor, to assist with aspects of the NFIP business; and a flood adjuster. FEMA and its program contractor manage and oversee the NFIP and the National Flood Insurance Fund accounts into which premiums are deposited and claims and expenses paid.

[11] The other 5 percent of policies are sold and serviced by state-licensed insurance agents and brokers who deal directly with FEMA.

[12] The fund, which was established in the Treasury by the 1968 legislation authorizing the NFIP, is the account into which premiums are deposited and from which losses and operating and administrative costs are paid. See 42 U.S.C. 4017.

[13] For example, the flood program manager from one insurance company said that agents receive a commission of 15 percent of the policy amount as an incentive to write flood insurance and may receive other incentives during special flood marketing campaigns.

Figure 3: Key Participants in the NFIP



Source: GAO analysis of FEMA data.

Insurance agents under contract to one or more write-your-own insurance company are the main point of contact for most policyholders to purchase an NFIP policy, seek information on coverage, or file a claim. In order to sell flood insurance, agents must meet basic state insurance licensing requirements. Based on information the insurance agents submit, the insurance companies issue policies, collect premiums from policyholders, deduct an allowance for expenses from the premium, and remit the balance to the National Flood Insurance Fund. In some cases, insurance companies hire subcontractors—flood insurance vendors—to conduct some or all of the day-to-day processing and management of flood insurance policies.

Insurance companies work with certified flood adjusters to settle NFIP claims. When flood losses occur, policyholders contact their insurance agents to report the loss. The agent then contacts the write-your-own company to report the loss and it assigns a flood adjuster to assess damages. Flood adjusters may be independentor employed by an insurance or adjusting company. These adjusters are responsible for assessing damage, estimating losses, and submitting required reports, work sheets, and photographs to the insurance company, where the claim is reviewed and, if approved, processed for payment. Adjusters determine prices for repairs by reviewing estimates of costs prepared by policyholders and their contractors, consulting pricing software and checking local prices for materials. Claims amounts may be adjusted after the initial settlement is paid if claimants submit documentation that some costs were higher than estimated. An adjuster must have a least 4 consecutive years of full-time property loss adjusting experience and have attended an adjuster workshop, among other requirements, to be certified by FEMA to work on NFIP claims,. To keep their certifications current, adjusters are required to take a 1-day refresher workshop each year and pass a written examination testing their knowledge each year.

Flood claims adjusters employed by write-your-own companies are paid salaries and sometimes bonuses for working long hours after major flood events from a percentage fee—about 3.3 percent of the incurred loss, which the NFIP pays write-your-own companies for settling claims, according to an NFIP official. Independent adjusters who work for multiple insurance companies are also paid based on a standard NFIP fee schedule that varies adjuster compensation according to the size of the claim. For example, the fee schedule pays $1,000 for a claim settlement of between $25,000 and $35,000. If the independent adjuster is registered with an independent adjusting firm, a portion of the fee goes to the adjusting firm.

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.

Due to Statutory and Regulatory Limitations, NFIP Payments May Not Cover All Costs to Repair or Replace Flood-Damaged Property

The amount of insurance coverage available to homeowners under the NFIP is limited, based on requirements set forth in statute and regulation.[14] First, by statute, there are limitations on the amount of insurance coverage homeowners may purchase for their dwellings and personal property. In addition, FEMA has further defined the general terms and conditions of flood insurance coverage pursuant to a broad grant of congressionally delegated authority, issuing regulations that include a SFIP. Because of these statutory and regulatory limitations, insurance payments to claimants for flood damage may not cover all of the costs of repairing or replacing damaged property.

In terms of statutory limitations, there is a ceiling on the amount of insurance coverage available for single-family homes, which is $250,000.[15] Because of this statutory ceiling, homes that could sustain more than $250,000 in damage cannot be insured to reflect full replacement costs. Furthermore, while homes whose full replacement cost is less than $250,000 may be fully insured, this is not statutorily required. There is a "mandatory purchase" requirement for homeowners in special high-risk flood hazard areas who hold mortgages from federally regulated lenders, but they are only required to insure their homes for the amount of their mortgages, which may be less than their homes' full replacement cost.[16] For homeowners in areas of low- to moderate-flood risk, the purchase and amount of insurance is optional, up to the $250,000 statutory maximum.[17] As a result of the $250,000 ceiling and the "mandatory purchase" floor, insurance on a given home may be less than its full replacement cost. Homeowners may also separately elect to insure the contents of their homes under the NFIP, although they are not required to do so. As with the $250,000 cap on building coverage, there is also a statutory limit on the

[14] As with homeowners' coverage, statutory and regulatory limitations apply to NFIP coverage for other types of property. See 44 C.F.R. Part 61, appendix A(1), "Standard Flood Insurance Policy Dwelling Form," appendix A(2), "Standard Flood Insurance Policy General Property Form," and appendix A(3), "Standard Flood Insurance Policy Residential Condominium Building Association Form."

[15] 42 U.S.C. 4013(b)(2).

[16] *Id.* 4012a(a), (b)(1).

[17] See *id.* 4012.

amount of personal property coverage homeowners can buy. By statute, homeowners can purchase no more than $100,000 in personal property coverage, even if the value of their personal property exceeds this amount.[18]

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," 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.[19] Pursuant to this delegation of authority, FEMA has issued regulations, including a "Standard Flood Insurance Policy," that further delineate the scope of coverage.[20] All flood insurance made available under the NFIP is subject to the express terms and conditions of the statute and regulations, including the SFIP.[21]

The SFIP is a contractual document that contains the terms of coverage and is issued to homeowners when they purchase flood insurance. Some of the principal SFIP limitations concern whether particular events, losses, building property and personal property are covered, and what deductible amounts and loss settlement methods apply when an insured files a claim. While either FEMA or private write-your-own insurance companies may issue flood insurance policies, FEMA's regulations prohibit any change to the SFIP provisions without the express written consent of the Federal Insurance Administrator, the FEMA official responsible for administering the NFIP.[22] The Administrator is also charged with interpreting the scope of coverage under the SFIP.[23]

[18] *Id.* 4013(b)(3).

[19] *Id.* 4013(a).

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

[21] 44 C.F.R. 61.4.

[22] *Id.* 61.13(d), (f).

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

The SFIP covers only "direct physical loss by or from flood."[24] It does not cover losses resulting from events other than flood, such as windstorms or earth movements. Additionally, if the losses primarily result from conditions inherent to the dwelling or within the control of the insured, they are not covered by the SFIP.[25] Nor does the SFIP provide coverage if the flood is already in progress when the policy begins or when the insured adds coverage. Finally, the SFIP only covers direct, physical flood losses, not indirect losses such as loss of revenue or profits, interruption of business, access to and use of the insured property, or living expenses incurred while property is uninhabitable.[26]

The SFIP limits what type of building property is covered, considering such things as the property's use, permanence, and degree of enclosure. For coverage purposes, the SFIP defines a "building" as a manufactured home; a travel trailer affixed to a permanent foundation; or a "structure with two or more outside rigid walls and a fully secured roof, that is affixed to a permanent site."[27] A building under construction may be covered even if not yet walled or roofed if the construction is underway at the time the losses are incurred.[28] Detached garages may be covered, but not if the garage is used for residential, business, or farming purposes,[29] in which case it must be separately insured. Certain items of property are considered part of the building. In general, these are items built in or affixed to the building, for example, stoves, ovens, refrigerators, central air conditioners, and permanently installed cabinets and carpets. At the basement level, building coverage is more limited and does not extend to finishing materials. For example, whereas the SFIP covers permanently

[24] The SFIP defines a flood as "[a] general and temporary condition of partial or complete inundation of two or more acres of normally dry land area or of two or more properties" caused by specified events such as the overflow of inland or tidal waters. SFIP section II, Definitions ("Flood").

[25] SFIP section V, Exclusions. For example, the SFIP would not cover water damage that primarily resulted from a structural defect in the insured's dwelling.

[26] SFIP section V, Exclusions.

[27] SFIP section II, Definitions ("Building").

[28] SFIP section III, Property Covered (Coverage A – Building Property). However, if the building under construction does not have at least two walls and a roof, the deductible amount is twice that which would otherwise apply. SFIP section VI, Deductibles.

[29] SFIP section III, Property Covered (Coverage A – Building Property). Coverage for a detached garage is limited to no more than 10 percent of the building's limit of liability. Use of this insurance is optional but reduces the building's limit of liability.

installed paneling and wallpaper above the basement level, coverage in the basement is limited to unfinished drywall.[30]

The SFIP only insures for personal property if the homeowner purchases personal property coverage and the personal property is inside a building.[31] Personal property includes movable items such as portable microwaves, window-type air conditioning units, and carpets that are not permanently installed. In a basement, coverage is limited to certain items installed in their functioning location and, if necessary for operation, connected to a power source, for example, portable air conditioning units and clothes washers and dryers. Certain types of personal property are specially limited to payment of no more that $2,500, regardless of the magnitude of the loss. These objects include artwork, collectibles, jewelry, furs, and property used in any business.[32] Personal property coverage does not extend to such things as currency, postage, deeds, and other valuable papers.[33]

Certain types of property are wholly excluded from both building property and personal property coverage. The first type of excluded properties are those that are generally separate from the main dwelling, such as recreational vehicles; self-propelled vehicles and machines; land, plants, and animals; walkways, driveways, patios; and hot tubs and swimming pools. The second type of excluded properties are those with a close relationship with water or that are located below ground, including buildings and personal property located entirely, in, on, or over water; boathouses, wharves, piers, and docks; underground structures or equipment; and buildings and contents where more than 49 percent of the actual cash value of the building is below ground.[34]

The amount recoverable under the SFIP is limited to the amount that exceeds the applicable deductible.[35] Applicable deductible amounts are not listed in the SFIP itself, but are shown on the Declarations Page, a

[30] SFIP section III, Property Covered (Coverage A – Building Property).

[31] SFIP section III, Property Covered (Coverage B – Personal Property).

[32] SFIP section III, Property Covered (Coverage B – Personal Property).

[33] SFIP section IV, Property Not Covered.

[34] SFIP, section IV, Property Not Covered.

[35] SFIP section VI, Deductibles.

computer-generated summary of the information provided by the insured in the insured's application. The Declarations Page is part of each insured's flood insurance policy. [36]

The final type of limitation found in the SFIP derives from the methods of settling losses. There are three loss settlement methods under the SFIP: (1) "replacement cost," which homeowners may only purchase for single-family dwellings in which they principally reside; (2) "special loss settlement," which only applies to large manufactured homes;[37] and (3) "actual cash value," which applies to any property that does not qualify for replacement cost or special loss settlement.

The only difference between replacement cost and actual cash value is the significance attached to the property's physical depreciation. An actual cash value loss settlement represents what it would cost to replace damaged property, less the value of its physical depreciation.[38] Because of depreciation, actual cash value will presumably be less than the full cost to repair or replace the damage.[39] A replacement cost loss settlement, on the other hand, does not deduct for physical depreciation. If replacement cost coverage applies, the policy will pay the actual amount spent to repair or replace the damage with materials of like kind and quality, subject to the applicable deductible and the building's limit of liability.[40]

Homeowners can only obtain replacement cost coverage for their single-family dwellings, not for multi-family dwellings or items of personal property, which are subject to actual cash value coverage. In addition, not all single-family dwellings are eligible for replacement cost coverage. To

[36] SFIP section II, Definitions ("Declarations Page").

[37] "Special Loss Settlement" combines elements of replacement cost and actual cash value settlements. Under the "Special Loss" rules, totally destroyed dwellings receive either replacement cost coverage or 1.5 times the actual cash value, whichever is less, up to the dwelling's limit of liability. Partially damaged dwellings are entitled to replacement cost coverage.

[38] SFIP section II, Definitions ("Actual Cash Value").

[39] An actual cash settlement may be increased to reflect a greater proportion of the costs of repairing or replacing damaged property, without deduction for depreciation. The SFIP provides a formula for calculating the proportion of the repair or replacement costs an insured with actual cash coverage is eligible to receive. The SFIP will pay this proportional amount if it is greater than the actual cash settlement.

[40] SFIP section VII, General Conditions, subsection V, Loss Settlement.

qualify for such coverage, a home must be insured for 80 percent or more of its full replacement cost or the maximum coverage amount of $250,000, and it must a principal residence. If a home does not meet both criteria, the policy will pay the actual cash value for the covered damage.

An additional limitation in replacement cost coverage applies when the full cost of repair or replacement is greater than $1,000 or 5 percent of the entire amount of insurance on the dwelling. In that case, the SFIP provides that it "will not be liable for any loss unless and until the actual repair or replacement is completed," unless the insured foregoes a replacement cost settlement and makes a claim for actual cash instead.[41] If the insured eventually spends more on the repair or replacement than the actual cash settlement, the individual may file a claim for additional replacement cost liability, provided he or she provides a notice of intent to do so within 180 days after the date of loss. [42]

We developed the following hypothetical property adjustment example with the assistance of FEMA's director of NFIP claims to illustrate how applicable limitations could reduce coverage for claimants whose property is damaged by flood:

> Hypothetical: A poorly maintained 30-year-old home located in a designated flood zone was damaged when a nearby river overflowed. The home's full replacement cost was $60,000. The homeowner purchased an NFIP policy for $30,000 in coverage. Although a contractor estimated it would cost $40,000 to repair damages to the structure and personal property losses totaled another $10,000, a NFIP adjuster determined that payment on the claim was $8,000 because:
>
> - The homeowner had chosen not to insure his personal property.
> - The adjuster determined that some problems that needed to be addressed had not been caused by the flood (e.g., leaking pipes in the bathroom and preexisting mold in the basement).

[41] SFIP section VII, General Conditions, subsection V, Loss Settlement.

[42] FEMA officials told us that the agency did not require Hurricane Isabel claimants to wait until after making repairs to obtain the full replacement cost. They also said that FEMA plans to amend its regulations to delete the requirement from the SFIP.

- The basement of the home, where the largest amount of damage occurred, was finished, and coverage was limited to drywall damage.

- Actual cash value will be paid for repairs or replacement of damage to the dwelling because the homeowner did not insure the structure for at least 80 percent of its full replacement cost. Because the condition of the home before the flood was poor, the actual cash value was low. In this hypothetical case, the adjuster determined that the actual cash value of damaged property covered by the policy was $9,000.

- A $1,000 deductible applied, reducing the $9,000 actual cash value payment to $8,000.

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

FEMA's primary method to monitor and oversee the NFIP is to conduct operational reviews of the 95 write-your-own insurance companies participating in the NFIP. In addition, FEMA's program contractor is to reinspect a sample of claims adjustments for every flood event to identify errors, among other things. The operational reviews and follow-up visits we analyzed followed FEMA's internal control procedures on the processes for examiners to follow in conducting the reviews and for doing the reviews at a pace that allows for a review of each write-your-own company on at least a triennial basis. The processes FEMA followed also met our internal control monitoring standard that requires federal agencies to ensure that the findings of audits and other reviews are promptly resolved. However, in doing these monitoring and oversight activities, neither FEMA nor its program contractor used a statistically valid method for sampling files selected for operational reviews or claims reinspections. As a result, FEMA did not meet our internal control standard that federal agencies have internal controls in place to provide reasonable assurance that program objectives are being achieved and that program operations are effective and efficient. Without a statistically valid sampling methodology, the agency 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.

FEMA's Operational Reviews of Insurers We Analyzed Identified and Followed Up on Problems

Operational reviews of flood insurance companies participating in NFIP that are conducted by FEMA staff are FEMA's primary internal control mechanism for monitoring, identifying, and resolving problems related to how insurers sell and renew NFIP policies and adjust claims. Our analysis of reports of all 15 operational reviews and follow up visits at companies that were identified as having critical errors (e.g., incorrect payments) found that FEMA checked information and conducted file reviews in accordance with the requirements and procedures outlined in its *Write Your Own Financial Control Plan*.[43] In addition, our analysis found that FEMA followed up at all of the companies where operational reviews had identified critical errors to monitor the progress these companies made over time in addressing and resolving critical errors. Monitoring the quality of performance over time and ensuring that the findings of audits and other reviews are promptly resolved is an internal control standard that we have identified for the federal government.[44]

According to the FEMA director of NFIP claims, one or two examiners from FEMA's NFIP Claims and Underwriting sections go on-site to review the operations of the 95 write-your-own companies. If vendors handle all or part of a company's NFIP business, operational reviews are conducted at the vendor locations and reviews of all of the companies doing business with the vendor can be completed during one visit. Seven FEMA staff in the Mitigation Division underwriting section and two staff in the claims section have primary responsibility for conducting operational reviews in addition to other responsibilities including writing insurance manuals and regulations, providing technical assistance, and responding to inquiries from policyholders, Members of Congress and others. As discussed below, FEMA directs examiners to conduct three steps for each operational review—a general underwriting review, a specific underwriting review, and a claims operation review of each insurance company's NFIP business. Requirements and procedures for the operational review are outlined in FEMA's *Write Your Own Financial Control Plan*.

In the general underwriting review, examiners are to review how the company has handled applications for NFIP policies and how policies are issued and cancelled among other items. The examiners are to check a

[43] National Flood Insurance Program, *The Write Your Own Program Financial Control, Plan Requirements and Procedures*, revised December 1, 1999.

[44] See GAO, Standards for *Internal Control in the Federal Government* (Washington, D.C.: Nov. 1999).

sample of files to determine, for example, whether NFIP policies were renewed using correct payment rates and whether appropriate documentation was included in the file. In the specific underwriting review and the claims operation review, examiners are to conduct detailed examinations of files to check for completeness and accuracy. For example, they must make sure that elevations are calculated correctly on new policies and that photographs document damage on flood claims.

For all aspects of the 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 on 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. If a company receives an unsatisfactory designation, FEMA requires that it 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 action plans developed by the companies generally must contain a timetable for addressing deficiencies, including a plan for making progress reports to FEMA and developing more stringent internal quality control procedures. If a company continues to have problems and fails to implement an action plan, it can ultimately be withdrawn from the NFIP. According to FEMA officials, a company has been required to withdraw from the NFIP once in the program's history in part because of issues raised in operational reviews and in part due to other financial problems.

In our analysis of reports of all 15 operational reviews and follow-up visits done at insurance companies that were identified as having critical errors, we found that examiners checked information and did file reviews in accordance with the requirements and procedures outlined in the *Write Your Own Financial Control Plan*. We also determined that FEMA followed up to monitor the progress the companies made in addressing and resolving critical errors. For example, in one instance after a write-your-own company received two unsatisfactory designations, it was directed by FEMA to rewrite all of its policies to be sure that the correct premiums were being charged to policyholders. In another instance, FEMA required a write-your-own company to take more extensive action than was proposed in its plan to address deficiencies.

In addition, according to information provided by FEMA, operational reviews completed since 2000 were on pace to meet FEMA's policy that each of the 95 write-your-own companies be operationally reviewed at least once every 3 years. Table 3 shows the number of operational reviews reported by FEMA from January 2000 through August 2005. FEMA has scheduled a review of 31 write-your-own companies at a large vendor location for later in 2005.

Table 3: Total Number of Operational Reviews of Write-Your-Own Companies Conducted by FEMA (January 2000 to August 2005)

Year	Number of companies reviewed
2000	43
2001	10
2002	33
2003	9
2004	42
January to August 2005	11
Total	**148**

Source: FEMA.

Reinspections of NFIP Claims Conducted by Program Contractor

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.[45] Procedures for the general adjusters to follow in conducting these reinspections are 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

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

with officials of the 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. If a general adjuster finds that the private-sector adjuster missed a covered expense in the original adjustment, the general adjuster will 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 over all during the 2004 hurricane season, cited several errors that he had identified in reinspections of claims, including improper measurement of room dimensions and improper allocation of costs caused by wind damage (covered by homeowners' policies) versus costs caused by flood damage. In addition, the instructor identified a problem that arose, namely, poor communication with homeowners on the process 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, quality 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

FEMA used nonprobability sampling processes rather than random sampling to select files for operational reviews and claims for quality assurance reinspections. In nonprobability sampling, staff select a sample based on their knowledge of the population's characteristics. The major limitation of this type of sampling is that the results cannot be generalized to a larger population, because there is no way to establish, by defensible evidence, how representative the sample is. A nonprobability sample is therefore not appropriate to use if the objective is to generalize about the population from which the sample is taken.[46]

For the operational reviews, specific guidance on how to select files for review is not documented, although guidance is provided on the number of files to review based on the size of the write-your-own companies' volume of NFIP business. The process used to select claims for review, as

[46] GAO, *Policy Manual* (Washington, D.C.: Jan.1, 2004).

it is described by FEMA managers who oversee operational reviews, identifies problems at the write-your-own companies, but it is not designed to assess overall performance. For the specific underwriting portion of the review, examiners use a process described by a FEMA official as adverse selection, or selection of files for review that include the most difficult new policies that the company underwrote in the period since the last operational review under the assumption that if the company addresses difficult underwriting issues correctly, it will also be able to do routine underwriting issues correctly. According to this official, some examples of the most difficult underwriting issues are policies covering properties in the flood hazard areas closest to bodies of water and elevated buildings that have enclosures underneath them. For the claims operation portion of the operational review, like the underwriting portion, an examiner said that FEMA attempts to select the more difficult or potentially troublesome claims files to review. In addition, files that are closed without payment and those with particularly large settlements are to be included in the sample of files reviewed. Thus, the operational reviews provide FEMA with management information on specific problems that occur at write-your-own companies but, by design, do not assess the overall performance of the companies.

For quality assurance reinspections, procedures are included in the written FEMA guidance on the number of claims to sample, but not on the sample selection process. General adjusters employed by FEMA's contractor are to reinspect a sample of properties based on the total number of claims the write-your-own company is processing for the flood event. A FEMA official said that this number is up to about 4 percent of claims for each flood event based on the total number of claims filed for the flood event. Although the two general adjusters we interviewed said their inspection sample selection process was random, the selection process they described involved choosing properties to reinspect based upon criteria they considered to be important. The general adjusters said that they generally reinspected the adjustments done on properties from a variety of neighborhoods that represented different types (i.e., single family and condominium) and values of houses, and varying flood loss claims amounts. A FEMA manager said that this process was comparable to the approach used by all nine of the general adjustors. While these criteria, if properly applied, would lead to some variety in the selection of claims to review, the selection process is not random or statistically valid for purposes of projecting results to overall performance. By exercising a more rigorous sample selection process, without incurring additional costs or selecting larger sample sizes, FEMA would improve its internal control processes.

Because FEMA's primary means of providing oversight are its operational reviews and quality assurance reinspections, statistically-valid information from these oversight activities is essential. However, FEMA's use of an approach that lacks statistical validity for selecting files for operational reviews and claims for reinspections does not provide management with the information needed to assess the overall performance of the write-your-own companies, including the overall accuracy of the underwriting of NFIP policies and the adjustment of claims—information that FEMA needs to have reasonable assurance that program objectives are being achieved. Without a statistically valid sampling methodology, FEMA did not meet our internal control standard that federal agencies provide reasonable assurance that program objectives are being achieved and that program operations are effective and efficient.[47]

FEMA Task Force Closed about Half of Hurricane Isabel Claims Reviewed with Additional Payments

FEMA took unique actions to respond to concerns regarding NFIP payments for Hurricane Isabel flood claims. In April 2004, about 7 months after Hurricane Isabel, FEMA established a task force to review claims settlements based on requests by Hurricane Isabel claimants.[48] It was the first time in the history of the NFIP that a formal review process was established for NFIP claimants who were not satisfied with actions taken on their claims. According to an NFIP official, the task force was comprised of about 50 current and former certified flood adjusters from various private sector flood insurance adjusting firms, the nine general adjusters employed by FEMA's program contractor, and three FEMA staff. Adjusters were assigned to review claims outside of states where they had previously adjusted claims for Hurricane Isabel damage, according to the official.

As shown in figure 4, FEMA officials said they sent notifications to 23,770 Isabel claimants in six states[49] and Washington, D.C., to advise claimants

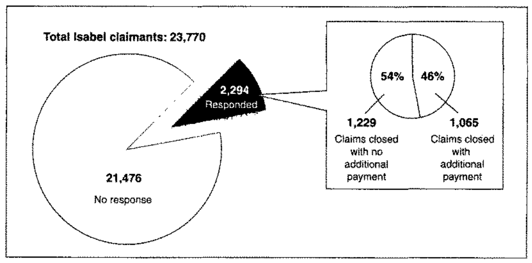
[47] In addition, the Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350, (2002), requires each executive agency to review all of its programs and activities annually and identify those that may be susceptible to significant improper payments. If DHS determines during the annual review that the NFIP is susceptible to significant improper payments, it will be required, in accordance with Office of Management and Budget (OMB) guidance, to report statistically valid estimates of improper NFIP payments to Congress before March 31 of the following applicable year.

[48] After the task force was created, the Senate Committee on Banking, Housing, and Urban Affairs affirmed the need for an independent review of Hurricane Isabel claims. See S. Rep. No. 108-262, at 5 (2004).

[49] Maryland, North Carolina, Virginia, Delaware, Pennsylvania, and South Carolina.

that they could have their claims reviewed by a special FEMA task force if they were unhappy with actions taken to settle them. Claimants could request a review by the FEMA task force in person at a community meeting, by telephone, mail, or fax. About 10 percent of the claimants who were notified (2,294)—all with property in Maryland, Virginia, and North Carolina—responded. In reviewing those claims, the task force determined that 1,229 of the claims should be closed with no additional payment and that 1,065 claims should be closed with additional payments.

Figure 4: Disposition of Hurricane Isabel Claims Reviewed by the FEMA Task Force



Source: GAO analysis of FEMA data.

Based on our review of a statistically representative sample of claims files selected from the 2,294 claimants that responded to FEMA that they wanted a task force review of their claims, the task force closed claims with no additional payment for a variety of reasons. For example:

- Task force agreed with the original determination that flood damage to parts of a basement were not covered.
- Task force agreed with the original determination that damage was not due to flood but to wind-driven rain.
- Task force agreed with the original determination that a claimant did not have coverage for personal property.

Based on our analysis, reviewers allowed additional payments most frequently to:

- Repair or replace building or personal property items that the initial adjuster did not include in the loss report.
- Pay a higher amount for materials, labor, or personal property items than the original adjuster had allowed.

In more than 90 percent of claims closed by the task force with additional payment, the reviewer determined that additional payments were due for one of these two reasons.[50] In 48 percent of the claims, additional payments were allowed for items that the initial adjuster did not include in the loss report, and in 43 percent of claims, additional payments were allowed to pay a higher amount for costs than the original adjuster had allowed. For example, in one claim we reviewed, the original estimate did not include coverage for a kitchen countertop and a cable television outlet that the reviewer included in the final claim settlement. In other claims, reviewers allowed higher prices for paint, dry wall, insulation, base molding, ceramic floor tile, and window trim, among other items, than had been allowed in the initial loss report. One general adjuster for FEMA's program contractor said that the original pricing was not an error in many cases, but that the costs of the materials had increased between the time of the initial loss and the final settlement offer.

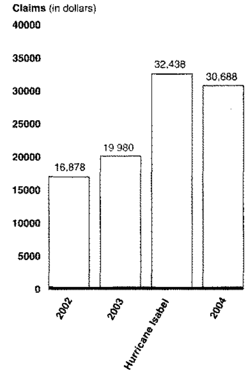
Based on our analysis of the statistically representative sample of 100 claims files reviewed by the FEMA task force, the average amount paid on claims closed with payments and for which claimants requested a review by the task force was $32,438.[51] The average additional payment amount

[50] In 9 percent of the cases, the task force allowed recoverable depreciation not allowed in the original settlement or determined that the claim should be paid for a primary residence at replacement cost value rather than for a seasonal residence at actual cash value. Some claimants received additional payments for more than one reason.

[51] This information was current at the time of the review of the claim by the task force and does not reflect any subsequent actions taken on the claim by the write-your-own companies. FEMA's program contractor reported that about 3,866 Hurricane Isabel claims were closed without any payment. Most frequently Hurricane Isabel claims were closed without payment because the adjuster report determined that the damages did not exceed the amount of the deductible on the NFIP policy. In other instances, policyholders filed a claim but failed to follow up by providing appropriate documentation of loss. In several instances, claims were filed for damage to seawalls, which are specifically excluded from coverage under the NFIP.

determined by the task force for claims that were closed with an additional payment was $3,340. In comparison, as illustrated in figure 5, the average closed payments for 2002, 2003, and 2004 for claims closed with payment were $16,878, $19,980, and $30,668, respectively.[32]

Figure 5: Comparison of Claims Settlement Amounts for Hurricane Isabel Claims Reviewed by the Task Force and All Claims Closed with Payment (2002-2004)



Source: GAO analysis of NFIP data.

[32] For claims in our file review, the median settlement amount—the point at which half of the cases were settled at higher amount and half were settled at a lower amount—was $15,583 before the task force review and $19,826 after the task force review. Data on median settlement amounts for 2002, 2003, and 2004 was not available.

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

As of September 2005, FEMA had not fully implemented NFIP program changes mandated by the Flood Insurance Reform Act of 2004 to (1) develop supplemental materials for explaining coverage and the claims process to policyholders when they purchase and renew policies and (2) establish, by regulation, an appeals process for claimants. The 6-month statutory deadline for implementing these changes was December 30, 2004. The act also required FEMA to establish minimum training and education requirements for flood insurance agents and to publish the requirements in the *Federal Register* by December 30, 2004. Although FEMA published a *Federal Register* notice of its requirements on September 1, 2005, the notice explained that FEMA intended to work with the states to implement the minimum NFIP standards through existing state licensing schemes for insurance agents. Thus, it is too early to tell the extent to which insurance agents will meet FEMA's minimum requirements.

For purposes of explaining coverage and the claims process to policyholders, the Flood Insurance Reform Act of 2004 required FEMA to develop three types of informational materials. The required materials are: (1) supplemental forms explaining in simple terms the exact coverage being purchased; (2) an acknowledgement form that the policyholder received the SFIP and any supplemental explanatory forms, as well as an opportunity to purchase coverage for personal property; and (3) a flood insurance claims handbook describing the process for filing and appealing claims.[53] FEMA officials said they had drafted an acknowledgement form and new insurance program forms to explain coverage to policyholders when they purchase and renew their insurance. FEMA officials said that these forms were final as of September 2005, and that they expected distribution to policyholders to begin in October 2005. While FEMA appears to have completed its implementation efforts with respect to the supplemental and acknowledgement forms, its flood insurance claims handbook does not yet fully comply with statutory requirements. FEMA posted a flood insurance claims handbook, dated July 2005, on its website in September 2005. The handbook contains information on anticipating, filing and appealing a claim, but does not include information regarding the appeals process that FEMA is statutorily required to establish through regulation. In its comments on our draft report, FEMA stated that it was offering claimants an informal appeals process pending the establishment

[53] Sections 202, 203 and 204 of the Flood Insurance Reform Act of 2004 contain these requirements.

of a regulatory process, and that the handbook describes this informal appeals process. However, by statute, the claims handbook must describe the regulatory process, which FEMA has yet to establish.

The establishment of a regulatory appeals process is required by section 205 of the Flood Insurance Reform Act of 2004. To address this requirement, FEMA officials said they had discussed the feasibility of maintaining a permanent task force to consider appeals—like the one created to review Hurricane Isabel claims. In commenting on a draft of this report, the acting director of FEMA's Emergency Preparedness and Response Directorate said that FEMA had rejected this plan, but he did not disclose any alternative plan detailing key elements of an appeals process such as how to initiate an appeal, time frames for considering appeals, the size of an appeals board, and the qualifications for membership, or how long the rulemaking process to provide for appeals by regulation might take. Therefore, it remains unclear how or when FEMA will establish the regulatory appeals process, as directed by the Flood Insurance Reform Act of 2004.

Finally, section 207 of the Flood Insurance Reform Act of 2004 required FEMA, in cooperation with the insurance industry, state insurance regulators, and other interested parties, to establish minimum training and education requirements for all insurance agents who sell flood insurance policies and to publish the requirements in the *Federal Register*. On September 1, 2005, FEMA published a *Federal Register* notice in response to this requirement.[54] In the notice, FEMA provided a course outline for flood insurance agents, which consisted of eight sections: an NFIP Overview; Flood Maps and Zone Determinations; Policies and Products Available; General Coverage Rules; Building Ratings; Claims Handling Process; Requirements of the Flood Insurance Reform Act of 2004; and Agent Resources. FEMA further 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 NFIP requirements through already established state licensing schemes for insurance agents. However, the notice did not specify how or when states were to begin implementing the NFIP training and education requirements. Given the recent publication of the *Federal Register* notice, and the states' eventual role in implementing FEMA's training and

[54] *See* Flood Insurance Training and Education Requirements for Insurance Agents, 70 Fed. Reg. 52,117 (2005).

education requirements, it is too early to tell the extent to which insurance agents will meet FEMA's minimum standards.

FEMA officials said that developing and implementing changes to the NFIP can have broad reaching and significant impacts for the millions of NFIP policyholders, as well as the private sector stakeholders upon whom FEMA relies to implement the program. As a result, the agency is taking a measured approach to making the mandated changes to ensure that it achieves results and minimizes any negative effects on policyholders and NFIP stakeholders. Nonetheless, without plans with milestones for completing its efforts 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 NFIP education and training requirements, FEMA cannot hold responsible officials accountable and track progress to ensure that these management improvements are in place to assist victims of future flood events.

Conclusions

A key challenge that FEMA faces in its role as coordinator of the federal disaster response efforts, including the NFIP, is to ensure through its monitoring and oversight efforts that programs are implemented in accordance with statutory and regulatory requirements across the nation. It is a difficult challenge to meet, as services are delivered primarily through a decentralized system of private-sector contractors, their employees, and their subcontractors. However, it is increasingly important that FEMA have assurances that program requirements are followed in light of the growing participation and increasing costs of its programs.

While FEMA's NFIP monitoring and oversight processes have identified specific problems with the delivery of services, the lack of statistically representative samples for processes to assess the accuracy of claims and adjustments limits FEMA's ability to project the results of its analyses in order to provide management information on the private sector's overall implementation of the program. Without such information, the value of FEMA's monitoring processes—operational reviews and quality assurance reinspections—as critical internal control activities is limited. Such information could also help the agency better identify potential needs for such things as additional training requirements or clarification of NFIP coverage and claims guidance, as identified in the Flood Insurance Reform Act of 2004.

FEMA officials have been working to address the consequences of the most devastating hurricane season on record, and these efforts have understandably put pressure on FEMA's resources, particularly since claims began to be filed for the damage from Hurricane Katrina. Nonetheless, the agency may continue to face challenges like those posed by Hurricane Isabel in implementing the NFIP until plans for addressing some of the key legislative requirements of the Flood Insurance Reform Act of 2004 are developed and implemented. Without establishing a roadmap and a schedule for meeting mandated time frames that have already elapsed, FEMA is limited in its ability to project when program improvements will be made.

Recommendations for Executive Action

To improve FEMA's oversight and management of the NFIP, we recommend that the Secretary of the Department of Homeland Security direct the Under Secretary of Homeland Security for Emergency Preparedness and Response to take the following two actions:

- use a methodologically valid approach to draw statistically representative samples of claims for underwriting and claims portions of operational reviews and for quality assurance reinspections of claims by general adjusters; and
- develop documented plans with milestones for implementing requirements of the Flood Insurance Reform Act of 2004 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 NFIP education and training requirements.

Agency Comments and Our Evaluation

On October 12, 2005, the Acting Director of FEMA's Mitigation Division provided written comments on a draft of this report. FEMA offered substantive comments on three issues (App. II). FEMA offered comments principally in three areas: (1) its disappointment that we had not directly addressed the issue of whether Congress intended the flood insurance program to restore damaged property to its pre-flood condition; (2) its view that the method of choosing its sample for operational reviews was appropriate and that its financial and internal controls are wide-ranging and include processes that we did not address; and (3) its view that contrary to the impression given in our draft report, FEMA has worked diligently to implement the requirements of the Flood Insurance Reform Act of 2004.

- FEMA expressed disappointment that our report made no explicit, unambiguous statement regarding whether Congress intended flood insurance to restore damaged property to its pre-flood condition. We believe we have addressed the issue consistent with our statutory mandate by explaining the statutory and regulatory provisions that affect both dollar ceilings and other coverage limitations. Section 208 of the Flood Insurance Reform Act of 2004 mandated GAO to conduct a study of aspects of the National Flood Insurance Program (NFIP), including "the adequacy of the scope of coverage provided under flood insurance policies in meeting the intended goal of Congress that flood victims be restored to their pre-flood conditions, and any recommendations to ensure that goal is being met." To address this mandate, it was necessary to consider the legal framework of flood insurance coverage established by the National Flood Insurance Act of 1968, as amended, and FEMA's implementing regulations. The amounts and limitations of flood insurance policy coverage are affected by both the statute and the regulations. In other words, flood insurance policies can only restore victims to pre-flood conditions within, but not beyond, the limits established by law and regulation. To address our mandate, we therefore explained the statutory and regulatory provisions that placed limitations on the amount claimants could recover under their flood insurance policies. Our April 2005 testimony[55] and this report make clear that the statutory ceilings on the maximum amount of coverage that can be purchased and the policy limitations that result from FEMA regulations may result in a policyholder's insured structure not being restored to its pre-flood condition.

- FEMA highlights a number of oversight and management procedures for the program, including those for financial management. It also noted that its method of selecting its sample for operational reviews was more appropriate than the statistically random probability sample we recommended. Most of the additional oversight and management processes and controls FEMA noted in its comments are for financial management—an area not included in the scope of our work. Our work focused on program implementation and oversight. During our review, FEMA managers described the operational reviews and claims inspections as the primary methods FEMA used for monitoring and overseeing the NFIP.

[55] See GAO, *National Flood Insurance Program: Oversight of Policy Issuance and Claims*, GAO-05-523T (Washington, D.C.: April 14, 2005).

- In support of its current sampling strategy for its operational reviews, FEMA cites a report it had commissioned in 1999—a report FEMA had not previously mentioned or provided to us. Thus, we cannot comment on that report or its recommendations. Nevertheless, although FEMA's current 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 the write-your-own companies, including the overall accuracy of the underwriting of NFIP policies and the adjustment of claims—information that FEMA needs to have reasonable assurance that program objectives are being achieved

- With respect to FEMA's implementation of program changes mandated by the Flood Insurance Reform Act of 2004, we described several actions FEMA had taken in its efforts to comply with the Act, while noting that it had not fully implemented the Act's requirements. In its comments on our draft report, FEMA said that it had been working diligently to meet the Act's requirements and had made further progress on certain initiatives, for example, by finalizing "Summary of Coverage" forms required by section 202 of the act and distributing them to policyholders purchasing or renewing their coverage after September 21, 2005. We have updated our draft report to reflect the new status information, but work remains to be done before FEMA fully implements other requirements of the Flood Insurance Reform Act of 2004. As we noted in our report, section 205 of the Act requires FEMA to establish a claim appeals process by regulation, and section 204 of the Act requires FEMA to describe this regulatory appeals process in its flood insurance claims handbook. Although FEMA commented that it was offering claimants an informal appeals process pending the establishment of a regulatory process, it must establish the regulatory process to be in compliance with the informational requirements of section 204 and the procedural requirements of section 205 of the act. Finally, although FEMA published minimum education and training requirements for flood insurance agents in the *Federal Register* in September 2005, FEMA has not established how or when states are to begin imposing these requirements on flood insurance agents. Thus, we believe our recommendation that FEMA develop documented plans with milestones for implementing the requirements of the Flood Insurance Reform Act of 2004 remains appropriate.

FEMA also offered a number of technical comments that we incorporated as appropriate.

We are sending copies of this report to the Secretary of the Department of Homeland Security. We will also make copies available to others upon request. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you have any questions, please contact me at (202) 512-8777 or jenkinswo@gao.gov or Christoper Keisling, assistant director at (404) 679-1917 or keislingc@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

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

Appendix I: Scope and Methodology

To address provisions in the Flood Insurance Reform Act of 2004 for a GAO study and report on issues related to the processing of flood insurance claims and the Federal Emergency Management Agency's (FEMA) oversight and management of the program, we assessed (1) the statutory and regulatory limitations on homeowners' coverage under the National Flood Insurance Program (NFIP); (2) FEMA's role in monitoring and overseeing the NFIP; (3) FEMA's response to concerns regarding NFIP payments for Hurricane Isabel claims; and (4) the status of FEMA's implementation of requirements of the Flood Insurance Reform Act of 2004.

To determine the statutory and regulatory limitations on homeowners' coverage under the NFIP, we reviewed the National Flood Insurance Act of 1968, as amended, its legislative history, and FEMA's implementing regulations, including its "Standard Flood Insurance Policy." We also discussed our review with officials of DHS Office of General Counsel.

To assess FEMA's role in monitoring and overseeing the NFIP, we examined program requirements and reports. We analyzed the results of 15 operational reviews and follow-up visits FEMA completed from 2001 through February 2005 to determine whether they were done in accordance with requirements and procedures outlined in FEMA's *Write Your Own Financial Control Plan* and GAO's *Standards for Internal Control in the Federal Government.* To determine whether FEMA met the standard for assessing the quality of performance over time and ensuring that findings of its operational reviews were addressed, we analyzed reports of the results of all reviews of insurance operations and follow-up visits at insurance companies where FEMA identified critical errors over a 10-year period, from 1996 to April 2005—a total of 15 reports. All of the reviews and visits for this 10-year period occurred from 2001 to April 2005 because for several years prior to 1999, FEMA did not conduct operational reviews. The reviews were restarted on a "practice" basis in 1999 and a regular basis in 2000. We also observed FEMA examiners as they conducted a portion of an operational review at a flood insurance vendor location and obtained information on the schedule of operational reviews from 2000 to June 2005. We obtained documentation on how quality assurance reinspections of claims adjustments are done after flood events and reviewed copies of several reinspection reports and examples of data maintained in the NFIP reinspection database, as well as aggregate information on the number of quality assurance reinspections done from 2000 to June 2005. We interviewed officials of FEMA and its program contractor about their oversight activities, and we discussed aspects of the process with private-sector insurance officials from four of the five largest write-your-own companies in terms of the number of claims filed in 2004. For example, we talked with FEMA officials about how claims files were selected for each operational review to examine write your own companies' claims underwriting and adjustment activities and talked with two of the nine general adjusters employed by FEMA's program contractor about how they reinspect the work of adjusters who prepare flood damage estimates and how they select properties to visit. We interviewed these two general adjusters because they had performed reinspections of claims adjustments for damage from Hurricane Isabel and from hurricanes in Florida in 2004. We did not evaluate FEMA's methodology for selecting sample sizes for its monitoring and oversight activities.

To determine FEMA's response to concerns about Hurricane Isabel claims payments, we reviewed a statistically valid sample of 100 claims files of claimants in Maryland, Virginia, and North Carolina who were not satisfied with their initial claims settlements and had their claims reviewed by a special FEMA task force. The claims files included documentation of actions taken on the claims by the write-your-own companies and the FEMA task force, as well as correspondence and documentation provided by the claimants. For this representative sample of claims, we determined the average additional amount paid on claims that were closed with an additional payment; the average amount of claims reviewed by the task force; and reasons claims were closed by the task force with and without additional payments. We based our analysis on the information in the files we reviewed; we did not verify the accuracy of the information in the claims files. We tested the reliability of claims payments amounts for the NFIP database on a statistically valid sample of 250 claims for all flood events in 2003 and 2004. We determined that the NFIP database was sufficiently reliable for our reporting purposes. We discussed the actions FEMA took to address concerns of Hurricane Isabel claimants with FEMA officials, as well as the two general adjusters we interviewed, other officials of FEMA's program contractor, and private-sector insurance officials. We did not interview NFIP policyholders who filed claims for flood damage after Hurricane Isabel because (1) such interviews would have provided anecdotal information that could not be used to make judgments about Hurricane Isabel claimants as a group or any subset of the group; and (2) we started our review more than a year after Hurricane Isabel occurred; thus, testimonial information would have been dated.

To determine the extent to which FEMA had implemented provisions of the Flood Insurance Reform Act of 2004, we examined documentation of the agency's efforts, including draft materials FEMA had prepared for distribution to policyholders. We also interviewed officials to determine what progress had been made and what milestones, if any, had been established to meet the legislative mandates.

We conducted our work in accordance with generally accepted government auditing standards between December 2004 and August 2005.

Appendix II: Comments from the Federal Emergency Management Agency

U.S. Department of Homeland Security
500 C Street, SW
Washington, DC 20472

FEMA

October 12, 2005

William O. Jenkins, Jr.
Director
Homeland Security and Justice
441 G St., NW
Washington, DC 20548

Dear Mr. Jenkins:

Thank you for providing the draft GAO report entitled, "Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program" for FEMA's review and comment. Based on FEMA's review, I am providing general and specific comments on this report. FEMA's primary comments fall in three areas, as follows:

- As I indicated to the GAO in my letter of September 23, 2005, to Norman J. Rabkin, I am disappointed that the issue regarding restoration of policyholders to their "pre-flood" condition and Congressional intent has not been directly addressed as FEMA would have expected based on the language in the Reform Act of 2004 and the GAO letter dated October 1, 2004 that DHS received prior to the initiation of this study. The GAO was instructed to investigate and report with regard to this issue and should provide an unambiguous statement as to its findings. Since in the subject report it is stated that the legislative history of the National Flood Insurance Program (NFIP) as well as the authorizing statute were examined, it would seem that the GAO found no expression of intent to restore properties completely to pre-flood condition.

  A relevant, similar issue was addressed by the GAO for Congress in 1986 when FEMA implemented certain limitations to basement coverage under the Standard Flood Insurance Policy. In that report, the GAO stated that:

  > "Under Section 1306, FEMA's Director is authorized to provide, by regulation, the general terms and conditions of insurability. This Section includes authority to specify the nature and limits of loss or damage in any areas covered by flood insurance; the classification, limitation, and rejection of risks; and any other terms and conditions relating to insurance coverage or exclusion which may be needed to carry out the program.
  >
  > FIA said its decision to limit flood insurance coverage of basement contents is authorized under several provisions of the act, including those cited above. We concur with this position." (Appendix I, page 8, "Flood Insurance – Federal Emergency Management Agency's Basement Coverage Limitations," GAO/RCED-86-10FS, January 1986).

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The basement coverage changes went through a public comment process as well as Congressional scrutiny and were sustained.

- The GAO has given prominence to a concern that is not the main issue and is based on only partial review of Program controls. With its report title and "highlights" section GAO has chosen to emphasize a rather arcane recommendation with regard to statistical sampling without noting, as the report itself states on Page 5 that "…the processes that FEMA had in place for operational reviews and quality assurance reinspections of claims adjustments met our internal control standard for monitoring federal programs" and later on page 21 that "The processes FEMA followed also met our internal control monitoring standard that requires federal agencies ensure that the findings of audits and other reviews are promptly resolved." Further, the report does not put operational reviews and claims reinspections in the appropriate context within the entirety of what FEMA does to provide oversight of the NFIP and the Write Your Own (WYO) Companies. It is misleading to characterize the operational reviews as "FEMA's primary method to monitor and oversee the NFIP." (Page 27) While very important, these operational reviews, as well as the claims reinspections, are only parts of a comprehensive Financial Control Plan that has effectively provided oversight and control of the WYO insurance operations of the NFIP as discussed below. Biennial audits by CPA firms, annual Inspector General financial audits, monthly editing of policy and claims transactions along with the statistical and financial reconciliations provide an abundant amount of random sampling and thorough review of WYO transactions. This information does not appear to have been considered by the GAO in its study. However, these monitoring and control mechanisms do have a bearing on the design and use of operational reviews and claims reinspections. It is difficult to understand how the GAO can reach a conclusion that FEMA is not meeting an internal control standard without a thorough consideration of all the controls and processes that FEMA has in place to provide oversight of the Program.

- FEMA is pleased to find that in one of its primary areas of inquiry, the GAO does not criticize FEMA's handling of the extensive review process of the loss settlements resulting from the devastating impact of Hurricane Isabel.

FEMA's Oversight and Management of the NFIP

The WYO Financial Control Plan was developed as part of the original implementation of the WYO Program in 1983. All WYO companies must adhere to it. The Plan consists of the following elements including the operation reviews and the claims reinspection program:

- Part 1 requires companies to have a CPA firm, on a biennial basis, conduct independent financial, underwriting and claims audits following GAO "yellow book" requirements. As part of these audits, random sampling of claims and underwriting files is required. The audit results are provided to FEMA.

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- Part 2 provides the procedures for the monthly reconciliation and review of financial statement and detailed policy and claim transactions submitted by the WYO companies.
- Part 3 is the claims reinspection program reviewed by the GAO.
- Part 4 requires monthly company certifications of the reconciled financial and statistical data submitted by the WYO companies.
- Part 5 incorporates the Transaction Record Reporting and Processing Plan (TRRP Plan) that requires the companies' monthly submissions of detailed policy and claims transactions. As already mentioned, these statistical records are reconciled each month with company financial statements. Routine system editing of the statistical transactions allows for reviews of such things as the proper rating of policies and whether claims have been submitted for valid policies in force and claim settlements being within policy limits. This requirement is for all records, not for only a sample.
- Part 6 incorporates the WYO Accounting Procedures Manual.
- Part 7 lays out the procedures for the Underwriting and Claims Operational Reviews that the GAO focused on in the report.
- A Standards Committee comprised of both insurance industry and Federal executives assists in providing oversight of WYO companies in meeting the requirements of the Financial Control Plan and provides recommendations to the FEMA Mitigation Division Director on actions that should be taken when a WYO company is failing to meet its responsibilities.

It is important to note that FEMA also continues to fund and participate with the Office of the Inspector General's annual financial statement and operations audit. Each year six WYO companies and the NFIP Direct business contractor are audited. This audit includes random sampling of policy and claims files as well as auditing of system transactions and financial statements.

As a result of the WYO Financial Control Plan activities, and conscientious follow up by FEMA with regard to various audit findings, the NFIP portion of the Inspector General's financial audit has always received a clean, unqualified audit opinion.

In 1999, prior to FEMA's reinstituting the underwriting and claims operational reviews, Deloitte and Touche, in a report commissioned by FEMA, recommended that the operational reviews should be largely based on the findings of their study to target certain areas. They further recommended that a broad based general operational review would not be effective to improve file handling weaknesses, but that there should instead be a focused approach. Additionally, they recommended that the intent of the operational reviews should not be assessment oriented. These recommendations, along with FEMA's risk assessment and determination of resource availability for this aspect of management and program control led to the current design of the operational reviews. This design is oriented to keying on certain higher risk and higher consequence aspects of underwriting and claims that might not be ferreted out through the variety of other Financial Control Plan mechanisms. Thus, there is a bias in the sampling of files. However, this affords the best opportunities to provide immediate feedback to companies on proper procedures and to rapidly effect changes.

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In summary, regarding FEMA's operations review and claims reinspection process, the draft report does state that FEMA follows the requirements of the Financial Control Plan (Page 21). The report also states that FEMA's process meets the GAO's internal control standard in that "the findings of audits and other reviews are promptly resolved" (p. 21). However, it also states that the GAO's standards are not met because FEMA does not use a statistically valid sampling technique to select files for the operations reviews or for the claims reinspections (introduction and Pages. 5, 21, 25, 26, 27, 34). In response, FEMA comments that the operations reviews do include a random sampling technique but were never intended to be based on statistically valid samples. Instead, they are used to select the more difficult cases based upon the judgment of FEMA's professional staff for the purposes of correcting improper handling by the WYO Companies and for training purposes. The claims reinspections and financial reviews are components of a more comprehensive financial control plan.

FEMA's Actions in Carrying Out the Mandates of FIRA 2004

Contrary to the impression conveyed by the draft report's other primary criticism, FEMA has worked diligently to meet the requirements of FIRA 2004. The materials required by Sections 202 (Supplemental form), 203 (Acknowledgement form), and 204 (Flood Insurance Claims Handbook) have been developed and distribution began September 21. The WYO Companies are now sending out the Supplemental (Summary of Coverage) form and at claim time the Claims Handbook. In connection with policy issuance the Bureau and Statistical Agent will begin sending out the Claims Handbook, the prior loss history required by Section 202 and the Acknowledgement form in December based on the NFIP statistical system reports for the month of October. The appeals process required by Section 205 to be established by regulation will be placed in the FEMA/DHS concurrence process this month, after which it will go to OMB for concurrence. The report to Congress on the use of Increased Cost of Compliance (ICC) coverage required by Section 206 is being prepared and will be placed in the FEMA/DHS concurrence process by the end of November 2005. The minimum training and education requirements for flood insurance agents in Section 207 have been established and published as a notice in the Federal Register on September 1, 2005, as required. A bulletin providing for the charging of additional premium only prospectively was been issued on May 23, 2005 in accordance with Section 209. In the next revision to the Standard Flood Insurance Policy, which requires regulatory action, these changes will be made in the policy.

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Thank you for giving FEMA the opportunity to provide input on the draft report.

Sincerely,

David I. Maurstad

David I. Maurstad,
Acting Director/Federal Insurance Administrator
Mitigation Division
Emergency Preparedness
and Response Directorate

Appendix III: GAO Contact and Staff Acknowledgements

GAO Contact

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Acknowledgments

Amy Bernstein, Christine Davis, Pawnee Davis, Wilfred Holloway, Deborah Knorr, and Raul Quintero made significant contributions to this report.

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United States
Government Accountability Office
Washington, D.C. 20548-0001

Testimony of
David I. Maurstad
Acting Director and Federal Insurance Administrator
Mitigation Division
Federal Emergency Management Agency
Emergency Preparedness and Response Directorate
Department of Homeland Security
Before
The United House of Representatives
Committee on Financial Services
October 20, 2005

Good morning Chairman Oxley, Ranking Member Frank, and Members of the Committee. I am David Maurstad, Acting Mitigation Division Director and Federal Insurance Administrator for the Federal Emergency Management Agency (FEMA) within the Department of Homeland Security. I appreciate the opportunity to appear today before the Committee to discuss the status of the National Flood Insurance Program (NFIP), particularly after the devastating effects of Hurricanes Katrina and Rita.

FEMA's Mitigation Division manages the NFIP – the cornerstone of the Nation's strategy to prepare communities for flood events. When I accepted the position of Acting Director of Mitigation, the NFIP became one of my most important responsibilities and a top priority. During my tenure, I have used my 25 years of experience in the insurance industry to help guide the successful implementation of this program.

This year's hurricane season represents a significant challenge for the NFIP. Hurricane Katrina was a monumental flooding event that was further exacerbated by the impact of Hurricane Rita. The magnitude and severity of flood losses related to these storms are unprecedented in the history of the NFIP. The challenges these storms have presented to the Mitigation Division – in terms of flood insurance claims handling, floodplain management, and mitigation planning and grants management – have never been encountered, on this scale, before.

Let me provide a context for what the NFIP, and the Nation, is facing. Since the NFIP's inception in 1968, $15 billion has been paid out to cover more than 1.3 million losses. In 2001, Tropical Storm Allison resulted in the NFIP's first billion-dollar storm with over 30,291 claims received totaling $1.1 billion. Just last year the 2004 hurricane season resulted in over 75,022 claims totaling close to $2 billion dollars paid out in NFIP coverage.

We estimate that Hurricanes Katrina and Rita will result in flood insurance claims that significantly exceed the highest number of claims filed from any single event in the NFIP's history, and well more than triple the total number of claims filed in 2004. Katrina and Rita-related NFIP claims could exceed $22 billion, far surpassing claims paid in the entire history of the NFIP.

These claims from those whose homes and businesses have been damaged or destroyed by Hurricane Katrina are not a new obligation – they are the result of a legal promise we made to these homeowners and business owners when Congress passed the National Flood Insurance Act of 1968 and subsequent revisions. Homeowners and business owner agreed to pay premiums, communities agreed to adopt building codes to mitigate flood dangers, and the federal government agreed to provide insurance coverage to policyholders after a disaster. Every single one of these claims represents someone who has taken the responsible course of action by purchasing flood insurance and paying premiums to the government. We not only have a legal obligation to honor our commitments, but we have a moral obligation to provide the coverage we've promised to provide.

Since the tragic events of the past six weeks, I have traveled to the Gulf Coast to meet and work closely with the Insurance Commissioners from the affected areas. After seeing the devastation first-hand and listening to State and local government representatives, insurance industry representatives, and flood victims, we have developed a post-disaster mitigation strategy that will carry us forward in the days, months, and years ahead. Now, more than ever, we must build on these already strong partnerships and remain engaged in developing and implementing innovative approaches and solutions to meet the many challenges we will face as we help the Gulf Coast rebuild stronger, safer, and smarter.

Today, I will focus on the National Flood Insurance Program's financial status, and highlight several aspects of our post-disaster mitigation strategy. This strategy aggressively provides critical flood insurance information to State and local officials, adjusters, home and business owners, and policyholders in the affected areas so that they may rebuild a stronger, less vulnerable Gulf Coast.

NFIP Financial Status and Related Issues

Congress authorized NFIP in 1968 following a series of hurricanes in the mid-1950's and 1960's. At that time, affordable flood insurance was not generally available from the private insurance industry. The concept was that the Federal government would make flood insurance available to the people if local governments would adopt and enforce measures to make future construction safer from flooding.

Today, more than 20,100 communities in all 50 States and U.S. Territories voluntarily participate in the NFIP, representing about 95 percent of all properties in the Nation's Special Flood Hazard Areas. The NFIP provides these communities with maps that identify flood risks and help local government decision makers determine how flood-prone areas are used and how buildings in these areas should be constructed. These maps, which we are in the process of modernizing and making more accessible to homeowners, are also used to determine flood insurance rates.

As previously stated, $15 billion has been paid out since the NFIP's inception to cover more than 1.3 million losses. Many of these claims occurred as a result of smaller flood events where no other Federal disaster assistance was available. Yet these property owners endured as much of an individual loss as those in larger events. In this regard, studies have indicated that insurance is the most efficient and equitable method of providing disaster assistance.[1] Since 1986, the NFIP has been financially self supporting for the average historical loss year. During periods of high losses, consistent with the law, the NFIP has borrowed from the U.S. Treasury. These loans have been repaid, with interest, from policyholder premiums and related fees, and at no cost to the Nation's taxpayers. Last year's claims activity represented a significant loss year for the NFIP, and the program exercised its borrowing authority in the amount of $225 million. This was only the fourth time since 1990 that the Program was in a borrowing position.

The NFIP currently insures in excess of $800 billion in assets. This covers more than 4.7 million policies for homes, businesses, and other non-residential property owners. Each year the NFIP collects approximately $2 billion in premiums and fees.

Hurricane Katrina was a catastrophic event. More than 225,000 flood insurance claims are likely to be filed.

The NFIP provides insurance at actuarial (risk-based) rates, including consideration for catastrophic losses, for newer construction, with approximately 76 percent of policyholders paying actuarial rates. For structures built prior to the mapping and imposition of NFIP floodplain management requirements less than full-risk rates are charged because flood risks were not fully known when these structures were built. Approximately 24 percent of policyholders pay less than full-risk rates. It is important to note the NFIP has never been capitalized.

Our authority to borrow from the Treasury is an essential part of the NFIP's financing for heavy loss years. Because of Hurricane Katrina, on September, 20, 2005, the President signed into law H.R. 3669, which increased the NFIP's borrowing authority by $2 billion.[2] Current flood insurance claims projections for Hurricanes Katrina and Rita indicate additional borrowing authority will be

[1] See GAO Report, PAD-80-39.
[2] See Pub. L. 109-65.

necessary. The total payout for Katrina alone may be as much as 10 times the highest annual loss, and 20 times the program's average historical annual losses.

As it has become increasingly apparent that Katrina/Rita-related claims will exceed the new borrowing authority by a substantial margin, the Administration will request that $5 billion be added to this authority. This "stop-gap" measure should allow sufficient borrowing authority to cover claims through mid- to late November, and also would enable us to work with this Committee and others to complete meaningful program reform recommendations. Such recommendations will be based on FEMA's long-term commitment to reduce the Nation's flood risks, as well as the NFIP's comprehensive mitigation principles to:

- Protect the NFIP's integrity by covering existing commitments and liabilities;
- Charge policyholders fair and actuarially sound premiums by phasing out subsidized premiums;
- Increase NFIP participation incentives and improving mandatory purchase enforcement where warranted;
- Increase risk-awareness among homeowners and consumers by improving information quality; and
- Reduce risk through proven mitigation practices and exploring new mitigation opportunities.

Protecting the NFIP's Integrity – Streamlining the NFIP Claims Process

Based on the first principle above, it is my job to ensure that, consistent with statute and regulations, flood insurance claims are handled fairly, equitably and in a timely manner. Given the catastrophic impact these events have had in the Gulf, a critical first step was to implement a simplified and streamlined claims process to help policyholders settle their claims quickly.

Utilizing state-of-the-art aerial imagery, up-to-date water-depth data, and information from extensive underwriting files, the Write-Your-Own (WYO) insurance companies are rapidly identifying insured properties that have been washed off their foundations, have had standing water in them for an extended period, or have only pilings or concrete slabs remaining. Under such circumstances, adjusters are waiving proof of loss requirements and fast-tracking claims up to the maximum insured value.

Using these streamlining methods, we expect to substantially reduce our normal adjustment times from what one would normally see under such extreme circumstances. To ensure ***all*** claims are handled quickly and fairly, we are closely monitoring the performance and procedures of the WYO carriers that are using these Katrina-specific processes.

Phasing Out Subsidized Premiums by Addressing Repetitive Loss Properties
As Gulf Coast reconstruction gets underway, and elements of the second principle – phasing out subsidized premiums – become salient, FEMA will continue seeking ways to remove repetitive loss properties (properties with two or more $1,000 flood insurance claims within a 10-year period) from the NFIP policy base. FEMA will work with the States, local governments, and Community Rating System (CRS) communities to mitigate these properties through elevation, relocation, flood proofing, localized flood control, and acquisition/demolition.

The Alabama and Mississippi areas affected by Katrina contain about 2,200 and 2,500 repetitive loss properties respectively (as of October 5, 2005). The Louisiana Parishes affected by Katrina contain nearly 20,000 repetitive loss properties.

Title I of the 2004 Flood Insurance Reform Act authorized FEMA to establish a Severe Repetitive Loss pilot program to address properties that flood more frequently and severely than the repetitive loss properties I just described. I am pleased that the FY 2006 Department of Homeland Spending bill that Congress recently passed authorized FEMA to transfer up to $40 million from the National Flood Insurance Fund to mitigate these properties. Louisiana Parishes affected by Katrina contain nearly 2,000 Severe Repetitive Loss Properties.

FEMA has designed a Severe Repetitive Loss Pilot and we are looking forward to implementing that pilot.

Increasing Program Participation through Incentives

The NFIP's foundation embodies the principle of increasing incentives for communities to participate in the Program, and a significant part of FEMA's Gulf Coast Mitigation Strategy looks to encourage communities to rebuild stronger. Our Community Rating System will play a major role in this effort. CRS provides insurance discount incentives to communities that are actively reducing their flood risk by implementing comprehensive floodplain management criteria that go beyond the NFIP's minimum requirements.

CRS communities that continually reduce their flood risks receive flood insurance premium discounts for their citizens representative of the degree of risk reduction achieved. Over 66 percent of the NFIP's policy base resides in CRS communities, and 3.1 million NFIP policyholders residing in these communities receive over $150 million in discounts annually.

There are currently 68 CRS communities in the Gulf Coast area. Our goal is to increase that number as our Gulf Coast area participating communities become engaged in a process that focuses on rebuilding stronger and smarter.

Improved Information to Increase Risk Awareness
Increasing risk awareness among homeowners and consumers with improved, succinct information also is one of the NFIP's basic principles. FEMA, through an aggressive education and outreach campaign, is continuously designing and upgrading informational material to increase the public's awareness of flood risks and to effectively keep our policyholders informed.

For instance, immediately following Hurricane Katrina, we distributed two documents to policyholders to help them through the claims process: The ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook.*** With the Chairman's permission, I would like to submit copies of these documents for the record. These easy-to-understand documents have been available in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers – as well as in Town Meetings – since September 1, 2005. I have personally handed these materials to State Insurance Commissioners in Alabama, Mississippi, and Louisiana, and we have distributed an informational CD containing these documents and other ready-to-print materials to field offices, State and local government offices, and the media.

Also, recognizing that a significant number of policyholders were displaced, FEMA has implemented several systems to reach policyholders early in the claims process. These systems have been particularly useful to those who are cut off from their usual sources of information and communication. For example, in the days immediately following Katrina, we cross-referenced a National Processing Service Center report of all callers who applied for disaster assistance and indicated they had flood insurance. We matched the addresses of damaged properties to NFIP policy addresses and connected insurance companies to their flood insurance policyholders. This system will now become standard operating procedure in future flooding events. It has enabled the WYO Companies to reach out to their NFIP policyholders and help them immediately when they needed it most.

This innovative system, and others, reflect FEMA's initiative to reach out to policyholders as early in the claims process as possible, with easy-to- understand information, recognizing that the sooner claims are settled, the sooner people can start rebuilding their lives and communities. For comprehensive information on the NFIP and flood insurance, policyholders can access our FloodSmart website at www.floodsmart.gov.

Reducing Future Risks through the NFIP
As the focus shifts from disaster response to disaster recovery, areas impacted by Hurricanes Katrina and Rita will begin considering the opportunities for rebuilding a less vulnerable Gulf Coast. However, the overwhelming desire to rebuild immediately must be balanced with the need to rebuild wisely.

Effective planning – based on updated risk assessments, sound floodplain management, solid mitigation principles, and applicable environmental management and historic preservation considerations – is a primary principle of our mitigation and NFIP strategies, and a critical first step in the Gulf's recovery process. We are teaming up with our Federal, State, and local partners to (1) provide communities with the resources they need to get the job done right; and (2) integrate NFIP code compliance assistance and incentives into our mitigation grant processes.

(1) Providing Resources
FEMA is committed to working with its partners to provide communities with state-of-the-art tools and resources they need to make informed planning and rebuilding decisions. We are working closely with our Federal partners, such as the Army Corps of Engineers and the National Oceanographic and Atmospheric Administration, to gather and use the best available data for developing advisory information and NFIP recovery maps. We are also working with the Environmental Protection Agency and the Department of Health and Human Services on cleanup issues related to reconstruction. Finally, we are engaged with the Heritage Emergency Task Force to ensure that mitigation strategies in the Gulf region adequately consider historic preservation and related matters.

Our Mitigation Assessment Teams are in the field gathering data on the performance of buildings and infrastructure. These teams are working closely with State and local officials to recommend improved building design and construction techniques, advocate new building codes and enforcement measures, and suggest mitigation activities that will improve community-wide disaster resistance.

Overall, FEMA, along with its Federal, State, community, and private sector partners, is making sure that technology, information, and resources are expeditiously provided to the Gulf coast and properly used during the rebuilding process.

(2) Increased Cost of Compliance and Mitigation
FEMA also is coordinating with States, local governments, and CRS communities to integrate Increased Cost of Compliance funds – money for NFIP policyholders to bring their structures up to existing flood-related building codes – into all relevant mitigation efforts. Finally, our Federal, State, and local government partnership will ensure that all Gulf-area mitigation proposals are based on sound risk assessments and approved mitigation plans.

Sound floodplain management planning and regulations save this country an estimated $1.1 billion in prevented flood damages annually, and structures built to NFIP criteria experience 80 percent less damage than structures not built to such standards. FEMA is determined to help Gulf Coast communities make reconstruction decisions that are based not only on sound floodplain management, risk assessment, and mitigation planning principles, but on higher protection standards. Creating stronger and safer communities reduces loss of life and property, enables individuals and localities to rapidly recover from future events, and lessens the financial impact on State, Tribal and local governments, as well as the United States Treasury.

Conclusion

In the wake of Hurricanes Katrina and Rita, FEMA is committed to supporting the Gulf Coast's recovery. In the near term, this will require ensuring adequate funding to fulfill our commitment to our NFIP policyholders. For the longer term, it will require working closely with the Gulf Coast's affected States, local governments, communities, and private-sector entities to support a reconstruction effort that results in safer places to live, work, and do business.

I would be pleased to answer any questions Committee Members may have.

GENE TAYLOR
4TH DISTRICT, MISSISSIPPI

COMMITTEE ON ARMED SERVICES

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Testimony of Rep. Gene Taylor (MS)
Housing Subcommittee of the House Financial Services Committee
Hearing on the National Flood Insurance Program
October 20, 2005

Thank you, Chairman Ney and Ranking Member Waters, for allowing me the opportunity to testify about the failure of the National Flood Insurance Program.

Hurricane Katrina produced an unprecedented storm surge of more than 30 feet on the Mississippi Gulf Coast. Thousands of homes, businesses, churches, and other structures were destroyed; including many that had never flooded since the French landed in 1699. FEMA is still not able to give us totals for the number of properties that suffered storm surge damage and how many of those did not have flood insurance, but it is clear that the surge damaged or destroyed tens of thousands of homes that had wind coverage but not flood coverage.

Now, the people whose properties were destroyed by an unimaginable disaster are being ridiculed by NFIP Director David Maurstad, former federal insurance Administrator Bob Hunter, and others who blindly defend the failed program. They would have you believe that the homeowners were all too stupid or too cheap to buy flood insurance and deserve no sympathy or federal assistance.

I publicly invite them to come to the Mississippi Coast, at my expense, and tell that to Jerry St. Pe, the former President of Northrop Grumman Ship Systems, to Ricky Matthews, the publisher of the Sun Herald newspaper, to U.S. District Judge Lou Guirola, and to prominent attorney and community leader Cy Faneca. Those diligent professionals share a common fate with thousands of other South Mississippians. Their homes were not in the mapped flood plain, they were never advised that they would need flood insurance, they purchased plenty of wind coverage to protect their homes from hurricane damage, and their insurers now are classifying their damage as flooding and denying their claims.

David Maurstad and other NFIP officials will claim that they encourage property owners outside the 100-year flood plain to buy flood insurance, but there has been no substantial effort to market flood insurance or even to educate lenders and insurers. The reliance on loan officers and insurance agents to sell flood insurance has been an absolute failure. They are not flood plain experts. They just look at the maps and tell their customers they do not need flood insurance.

My legislation, H.R. 3922, the Hurricane Katrina and Hurricane Rita Flood Insurance Buy-In Act, is a fair way to help homeowners who did not purchase flood insurance because they were poorly advised of their risk by their government and by their insurance agents. Only those properties that are outside of FEMA's special flood hazard areas are eligible for the buy-in. The bill would allow the owners to buy-in to the flood insurance program and file claims for Katrina damage. To buy in, the owner would have to pay the equivalent of 10 years of premiums plus a five percent penalty, even if they owned the property for less than 10 years. The premium and penalty could be deducted from their claim payment.

The buy-in properties would be eligible for coverage for Katrina damage only up to the amount of their wind coverage. This would ensure that the new flood coverage would match the owner's own efforts to insure against storm damage.

The buy-in customers would have to sign an agreement that would require the property to be covered by flood insurance in the future. The buy-in will cover the structure only, not its contents. All of these restrictions would help ensure that those who buy-in will not have better coverage than those who have been paying into the program. The bill specifies that funding must come from a separate appropriation so that current NFIP policyholders are not adversely affected by the buy-in. Also, the buy-in payments are not to be considered by NFIP in setting premiums in the future.

The defenders of the current dysfunctional program have criticized my bill by claiming it would discourage people from purchasing flood insurance. I have to ask them, "Who is buying it now, except those required by their mortgages and those who have previously suffered a flood?"

I am astonished that so many people would try to defend such a failed program. The current framework for flood insurance is very badly flawed. The federal and state governments have enabled insurance companies to exclude flood coverage everywhere, not just in high-risk areas. The federal flood insurance program is mandatory only within the 100-year flood zones, and only then for properties with a federally guaranteed mortgage. That setup is designed to fail. It guarantees that there will be many properties at low to moderate risk of flooding that will not have flood coverage but are vulnerable to a major flood event.

That coverage gap is much worse if the 100-year flood maps are as grossly inadequate as the maps in Mississippi. FEMA now says the 100-year flood elevations should have been as much as eight feet higher on the Mississippi Coast. The map makers are now admitting that many of the properties that were flooded by Katrina should have been in the 100-year flood zones where flood coverage is mandatory. This admission means the owners will have to purchase flood insurance in the future if they are able to borrow the funds to rebuild their homes, but they get no apology or assistance for our nation's costly errors.

I would like to show you a few maps and images of the Gulfport coastal area to demonstrate just how inadequate the FEMA maps are.

First poster: FEMA Flood Insurance Rate Map for West Gulfport. The darkest areas are the 100-year flood zone, the only area where flood insurance is mandatory. The gray areas are the 500-year flood zone. Most of the map is white, meaning it is not in the 500-year flood zone.

Second poster: NOAA aerial photo of Gulfport two days after Hurricane Katrina. Barges and containers from the Port of Gulfport came to rest beyond the 500-year flood zone. Only the foundations remain of many of the houses. The railroad, about 20 feet above sea level, served as a levee, dividing the catastrophic damage from the severe damage.

Third poster: US Army Corps of Engineers Evacuation Map of Gulfport. The Corps' evacuation map is based on storm surge inundation models.
Evacuation Zone A could be inundated by a Category 1 or Category 2 hurricane.
Evacuation Zone B could be inundated by a Category 3 hurricane.
Evacuation Zone C could be inundated by a Category 4 or 5 hurricane.

The Army Corps of Engineers evacuation maps are much more accurate than the NFIP flood maps. If the flood insurance program had used accurate maps, such as the Corps' maps, most of the damaged properties would have been covered by flood insurance.

Last week, FEMA presented advisory flood elevations to local officials and flood managers. FEMA has admitted that the 100-year flood elevations in the current maps are as much as 8 feet too low along the Mississippi Coast. However, FEMA says they cannot require new elevations and standards because their official process of revising the maps will take about two years. They are recommending that local governments raise the base flood elevations by 6 to 8 feet in Harrison County, 4 to 6 feet in Hancock County, and 3 to 5 feet in Jackson County. They also recommend that local governments require stronger "V-zone" construction standards in some areas that obviously are subject to waves. At least a few local elected officials have made it clear that they do not want the responsibility of telling home and business owners that they must build higher. If the federal government wants properties to be rebuilt to the new elevations and standards, Congress should implement interim flood elevations while we wait for the new maps.

As we consider the future of flood insurance, I encourage my colleagues to challenge the whole idea of separating wind coverage from water coverage. Wind and water are not separate events in a hurricane or tropical storm. People should be able to buy one insurance product that would cover all their storm damage. They should not need engineers to determine whether their neighbors' house was slammed into their home by wind or by water. Wind and water should be included in one policy; either a private insurance product backed by a risk pool or a government reinsurance fund or, if the insurers refuse to participate, by a government disaster insurance program that is mandatory in coastal areas.

I can only guess that the current system was created by and for the insurance industry. They get government sanction to exclude water damage everywhere, not just in high risk areas. They get a commission of 30% of the first year's premium, while assuming no risk, yet still do not try to sell many policies. There is an obvious conflict of interest when their adjusters are allowed to determine whether storm damage was caused by wind or by water. I urge the committee to rethink our approach to insuring citizens against hurricanes and other disasters.

Thank you again for allowing me to testify today. I will close by urging the committee to pass H.R. 3922 so that the residents of the Gulf Coast can rebuild their homes. I know that assistance for those without flood insurance could be expensive, but the alternative is costly also. Without some help for the homeowners, the economy of the region will be depressed for years to come, there will be many bankruptcies and defaults, and far too many people will be dependent on FEMA trailers and other government assistance.

WRITTEN STATEMENT AND REPORT OF

STEVEN J. KANSTOROOM
PATTERN RECOGNITION AND FRAUD DETECTION EXPERT

BEFORE THE

HOUSE OF REPRESENTATIVES HOUSING AND COMMUNITY OPPORTUNITY SUBCOMMITTEE

"MANAGEMENT AND OVERSIGHT OF THE NATIONAL FLOOD INSURANCE PROGRAM"

OCTOBER 20, 2005

This report and its embedded links to documents and video referenced herein can be viewed online at
www.femainfo.us

Mr. Chairman, thank you on behalf of my organization, www.femainfo.us , for allowing me to submit testimony on this vital issue.

I have investigated problems within the Federal Emergency Management Agency (FEMA), its National Flood Insurance Program (NFIP) and its business partners for two years. I have found substantive wrongdoing that has impacted victims from 16 states. My investigation is ongoing.

I regret that I was unable to testify in person. I am currently in the Gulf Coast Region helping to publicize the plight of the victims who have been wrongfully denied disaster assistance and, in many cases, flood insurance claims payments.

The problems that I testified to in April, and spoke with you about in July, are continuing unabated in the Gulf Coast Region. Particularly problematic is the sales agent/flood adjuster training disparity.

Pre-flood Condition
Much has been said about the original intent of the NFIP, and if it was ever meant to restore policyholders to their pre-flood condition for a covered peril.

Since we last spoke, FEMA whistleblowers have come forward and offered their account of the intent of the program at its inception. They would very much like to testify before your Committee. Hopefully the GAO report will be in synch with the whistleblower accounts.

Regardless of the intent of the program, or the GAO report, the NFIP continues to train sales agents that the policy will restore victims to their pre-flood condition for their covered perils, yet simultaneously trains claims adjusters to allow only narrowly defined coverage in limited amounts.

Regardless of what may be said about the original intent of the NFIP, to sell the NFIP product as a Replacement Cost Value insurance policy, as the NFIP does, and deliver only fractional coverage, is flat wrong.

Claims Adjuster Abuses and Reports of Fraudulent Testing
Like so many before them, Hurricane Katrina survivors in the Gulf Coast states are now being victimized by the same tactics that have plagued survivors of prior floods. The tactics are described in general in my April 14, 2005 written testimony before this Committee, and in particular in Attachment 14 .

In many cases, the adjusting abuses are being carried out by some of the same firms that are named in the $2 billion lawsuit that was filed in June 2005 alleging fraud against FEMA, its business partners and others.

Other equally serious problems have surfaced. For example, the current NFIP regulations do not require claims adjusters to have any training if they are working on behalf of the private insurance carriers that sell flood insurance, known as "Write Your Own" (WYO) carriers, such as Allstate, State Farm and Fidelity. The adjusters are only required to be NFIP certified, "in some cases" according to FEMA's website. The certification consists of a one day training and written test. The test does not contain any questions that relate to construction knowledge; however, it does test rudimentary knowledge of the policy.

I received the attached affidavit from a flood claims adjuster, Mr. Alan L. Jackson. Mr. Jackson is also a practicing attorney. Mr. Jackson states in the affidavit that Computer Sciences Corporation (CSC), the company that handles the day-to-day affairs of the NFIP, provided the test answers to test takers.

Mr. Jackson described an adjuster training session that took place in Mississippi shortly after Katrina struck. According to Mr. Jackson, many of the prospective flood adjusters had never adjusted a claim of any type, and remarkably, the CSC trainer provided the test answers to more than 500 adjusters. It is believed that these untrained adjusters were then unleashed on unsuspecting Katrina and Rita victims.

I received a similar account of a CSC training that was conducted in another state prior to Katrina.

Moreover, victims from the Gulf Coast Region are reporting the same low-balling tactics that I brought to the Committee's attention in April. The bottom line is that Katrina and Rita victims are wrongfully receiving pennies on the dollar for their flood claims and, like thousands before them, will be unable to rebuild their homes and lives without immediate action on the part of Congress.

Many of the fundamental solutions to these problems are contained in my April 14, 2005 testimony in Attachment 14.

Document Requests and Interrogatories

In May I wrote document requests and interrogatories for Committee members to submit to FEMA on the record. As you know, this method was used in part to ameliorate the issues with the Department of Homeland Security Inspector General's office that Congresswoman Davis attempted to bring to the President's attention in January 2005.

I understand that to date, FEMA has failed to respond to the requests, yet I believe it will become increasingly evident that these documents and responses will reveal the underlying cause of many of the NFIP's problems.

Moreover, when Congresswoman Waters asked Acting Director David Maurstad about the status of the requests two months later at the July 12, 2005 hearing, Mr. Maurstad stated "we have responded or are in the process of responding to every request that came to our office." Yet, I am told by Congressional staffers that no response from FEMA has been received.

Nebraska Department of Insurance

I believe it is important that the Federal Insurance Administrator have an understanding of insurance. It is public knowledge that Mr. Maurstad had close ties to the insurance industry.

At the time that the interrogatories and document requests were made, the Nebraska Department of Insurance (DOI) website indicated the Mr. Maurstad had been licensed to sell insurance for a number of the same companies that NFIP records show he was regulating. Since the document requests and interrogatories were submitted, the Nebraska DOI website no longer has any reference to the brokerage licenses that Acting Director Maurstad held.

White House Response

Shortly after Katrina struck, the White House responded to Congresswoman Davis' January letter. The response indicated that no problems exist in the NFIP. It was silent on the training disparity and seemed to confuse premium funded NFIP policies with taxpayer funded Federal Disaster Assistance. The letter was also silent on the Inspector General's issues.

Summary

Whistleblowers have continued to come forward sending me in some cases massive amounts of insider documents which demonstrate wrongdoing on a large scale within FEMA, its NFIP and its business partners. Beginning in August and continuing through

October, six defendants in the NFIP suit have resigned, including the President of CSC, Paul Cofoni and FEMA Undersecretary Michael Brown.

I am continuing to receive calls and emails from desperate victims that are in the fight of their lives. Each has been shortchanged by the NFIP and its business partners. Late last week I received a call from a family living in a tent at a truck stop in Louisiana - two adults, three children and their three small dogs. They have frantically tried to reach FEMA, yet the contractors handling the inbound phone calls give incorrect information and deny their requests for assistance. I have personally called the NFIP Claims line and FEMA Call Center as well. I know first hand that the centers are providing information inconsistent with the NFIP regulations and the Stafford Act in the case of disaster assistance.

Consequently, families are struggling to survive in situations that are beneath conditions found in some third world nations.

I urge you and your Committee to join with Senators Allen, Dole, Mikulski and Sarbanes and Congresswoman Davis in their call for a Department of Justice investigation into the wrongdoing that I have uncovered or that has occurred in some cases in an effort to interfere with my investigation. I also urge you and your Committee to take the steps I outlined in my April 14, 2005 testimony to correct the training disparity and adjusting abuses that continue to destroy American families.

Without immediate action, New England families will be the next to suffer the consequences of the problems I have uncovered. I remain willing to work with Congress and FEMA to institute the changes desperately needed by so many victims such that victims receive the insurance payments and disaster assistance to which they are entitled.

Independent Insurance Agents & Brokers of America, Inc.

TESTIMONY OF THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE REGARDING THE THE NATIONAL FLOOD INSURANCE PROGRAM OCTOBER 20, 2005

The Independent Insurance Agents & Brokers of America, Inc. (IIABA) present the following testimony to the United States House of Representatives Committee on Financial Services concerning the National Flood Insurance Program (NFIP). IIABA is the nation's oldest and largest national trade association of independent insurance agents and brokers, and represents a network of more than 300,000 agents and agency employees nationwide. IIABA members are small and mid-size businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents offer all lines of insurance – property, casualty, life, health, employee benefit plans and retirement products.

IIABA believes that the NFIP provides an essential service to people and places that have been hit by a natural disaster. In the past the private insurance industry has been largely unable to underwrite flood insurance because of the catastrophic nature of these disasters and the potential for insolvency. Therefore, the NFIP is virtually the only way for people to protect against the loss of their home or business due to flood. Prior to the introduction of the Program in 1968, the Federal government spent increasing sums of money on disaster assistance to flood victims. Since then, the NFIP has saved disaster assistance money and provided a more reliable system of payments for people whose properties have suffered flood damage.

IIABA believes the Flood Insurance Reform Act of 2004 (FIRA) was a milestone for the NFIP. This law reauthorized the Program for 5 years and includes a number of important provisions that will ultimately improve this crucial risk management program. IIABA also supports H.R. 804, a bill sponsored by Subcommittee Chairman Baker and passed unanimously by the House of Representatives. H.R. 804 amends the National Flood Insurance Act of 1968 to declare that assistance provided under a program for flood mitigation activities with respect to a property shall not be considered income or a resource of the owner of the property when determining eligibility for or benefit levels under any income assistance or resource-tested program that is funded in whole or in part by a federal agency or by appropriated federal funds.

IIABA is confident that the FIRA will be extremely beneficial once fully implemented; however, there is a degree to which FIRA did not go far enough, as there are certain areas of reform not addressed in the law that we believe would not only enhance consumer protection, but the overall integrity of the NFIP. Furthermore, there are a number of vitally important FIRA provisions – such as the repetitive loss mitigation pilot program and a comprehensive policyholder appeals process – that have yet to be funded or implemented nearly 16 months after FIRA was signed into law. IIABA contends that such a significant delay in the implementation of provisions limited to a 5-year reauthorization severely undermines their overall effectiveness.

An important principle not included in FIRA that we believe needs to be addressed is a requirement for mandatory disclosures of flood information. One of the best ways to avoid future problems with the NFIP is to give people information about flood risks. Many people in the country originally bought their properties without knowledge of the risk of flooding, and FEMA should take the appropriate steps to protect consumers against any unexpected consequences prior to the purchase of a home. The NFIP should implement mandatory disclosures of the flood history of the property so that buyers can make an informed choice in their purchases and they can properly value the home.

To make mandatory disclosure effective, an accessible electronic database of flood losses should be created. Disclosure of flood information will help ensure that when a tragedy strikes in the future, NFIP does not have to pay for an artificially overvalued property. IIABA believes that such a disclosure could bring more people into the Program by giving them the information about their risks and the importance of purchasing coverage. In the aftermath of the 2005 hurricane season and its subsequent devastation on the gulf coast, increased participation is crucial for the NFIP's long-term financial integrity.

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

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

Finally, IIABA would like to address an issue that greatly concerns agents who sell and service policies under the Program. FEMA has proposed a rule that would harm the position of insurance agents participating in the Write-Your-Own (WYO) program and, ultimately, be detrimental to the NFIP. The proposed rule, published in the Federal

Register on October 14, 2003, would amend the Federal Insurance Administration, Financial Assistance/Subsidy Arrangement. Paragraph 61.5(f) of the FEMA proposed rule would change current standard practice by designating independent property and casualty agents as "agents of insureds," not agents of private WYO insurers, for the purposes of selling and servicing NFIP policies. Currently, the status of an insurance producer as an agent or broker is a contractual issue determined by the producer and insurer.

The regulatory intervention by FEMA into private contractual relationships between insurers and their agents is a drastic departure from the way the NFIP has functioned since 1983 when private insurers were brought into the program. FEMA's proposed rule undermines the agent's ability to establish a contractual relationship and, therefore, alters the rights and responsibilities provided for in such contracts.

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

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

We thank the Committee for giving us the opportunity to express the views of the IIABA on this important Program. We hope very much that our concerns contribute to any additional action taken by the Committee to ensure prosperous growth and stability of the National Flood Insurance Program.

Statement of the

National Association of Professional Insurance Agents

Submitted to the

Committee on Financial Services
Subcommittee on Housing and Community Opportunity

United States House of Representatives

Regarding:

The Future of the National Flood Insurance Program

Thursday October 20, 2005

Patricia A. Borowski
Senior Vice President
National Association of Professional Insurance Agents

The National Association of Professional Insurance Agents represents independent insurance agents in all 50 states, Puerto Rico and the District of Columbia. Our member agents sell and service all kinds of insurance, specializing in personal lines and commercial lines.

Many PIA member insurance agents are active in selling policies backed by the National Flood Insurance Program (NFIP). In addition to PIA's current level of involvement with the NFIP both through the active participation of our members in NFIP programs, PIA has been active in public policy development regarding issues relating to flood insurance since before the inception of the NFIP.

This testimony reflects PIA National's internal expertise developed over the years of its regular participation in the National Flood Insurance Program process and the collective experiences of PIA members who write flood insurance through NFIP.

PIA is also a founding member of the Flood Insurance Producers National Committee (NFIP). FIPNC was organized by the then-Federal Insurance Administration (FIA) for the purpose of providing expert guidance from insurance agents that each day write federal flood insurance business as a regular part of their larger property and casualty insurance agency business.

Further, by asking PIA national and other producer trade associations to appoint the FIPNC member liaison, FIA (now FEMA) and the agent liaison has the support and access of the broad national membership of PIA and their collective and regional experiences with the NFIP, so that FIPNC presents a more holistic realty.

Profile of the PIA Member Agency

PIA National members are the owner-principals of their independent insurance agencies. They employ an average of seven to eleven full-time individuals including themselves, who are licensed as insurance producers. Additionally, they employ two to four individuals who are not licensed producers. PIA members represent an average of between five and ten property and casualty carriers, and two to three life and health carriers.

PIA & The National Flood Insurance Program – Background

In the 1960's PIA (then known as The National Association of Mutual Insurance Agents) believed that with the proper underwriting, countrywide rate zoning and special treatments for reserves for catastrophic losses, flood and earthquake insurance could be provided to property owners. For many reasons this goal was not possible to achieve through private sector insurance, and therefore PIA led successful efforts to create a federal insurance program providing needed flood coverage for homes and businesses. PIA members in the District of Columbia, Virginia and Maryland wrote the first 100 policies sold under the National Flood Insurance Program following its establishment by Congress in 1968.

The Future of the NFIP

The following is a discussion of the leading issues PIA National believes are critical to a viable and successful NFIP program in the future that achieves the desired outcomes for insureds and communities.

1. **NFIP Buy-Back After Flooding**

In the aftermath of the recent twin natural catastrophes, Hurricane Katrina and Hurricane Rita, discussion has ensued as to the best way to insure properties against damage from flooding.

PIA strongly supports action by the federal government to help the victims of these catastrophes rebuild their lives. It is also critical that disaster relief efforts address the need to stabilize the economies of our Gulf Coast states, as part of a comprehensive program of community redevelopment. Further, rebuilding is crucial to the economy of the entire Southeastern section of our country. That is what federal disaster assistance is meant to do. Federal disaster monies used in this effort are an investment by all U.S. taxpayers in the continuing vitality of the entire U.S. economy. Recently, draft legislation (H.R. 3922) was introduced in the House of Representatives that seeks to provide disaster assistance to the victims of flooding, but would do so in a manner that PIA National believes to be problematic.

While we support the objective of providing such assistance embodied in the Hurricane Katrina and Hurricane Rita Flood Insurance Buy-In Act (H.R. 3922) and while we appreciate the goals intended by its principal author Rep. Taylor of Mississippi, we believe such an NFIP after-the-fact insurance coverage buy-back offer from Congress to those that lost or had damage to their property in Katrina and/or Rita is a well intentioned error.

In addition to this being anathema to the entire concept of insurance – defined as covering the potential of possible loss – this legislative proposal directly conflicts with the very specific expressed mandates that Congress has set in place for the NFIP to include property owner and mortgage lender obligations, and provide penalties for failing to meet these obligations. These have been imposed by Congress to provide similar incentives as those established by lenders, and have existed for over 125 years between and among property owners and mortgage lenders in the general private sector property insurance market.

Further, the buy-back penalties that would need to be imposed upon citizens taking advantage of H.R. 3922 would result in many receiving little. This would fail to serve the necessary financial scope of the cost of rebuilding, and unintentionally place a burden few could afford to bear.

However, we believe it may be worth considering using the facilities and in-place process of the NFIP to "deliver" through it the already earmarked federal disaster relief monies that would be going to these affected property owners for the purpose of rebuilding.

In this way, the federal government has an established vehicle to deliver this aid. FEMA can then track such building locations and make as an obligation of these relief payments that the rebuilt structures secure and continue to maintain NFIP insurance, ensuring that all such rebuilt structures are maintained to flood mitigation standards.

Should owners elect not to rebuild, NFIP could then track those "plots" to assure any future owner secures and maintains continuous NFIP coverage, and complies with flood mitigation requirements.

In this way Congress achieves both goals: immediate aid relief and future flood coverage protection, without sacrificing the integrity of the insurance aspects of the NFIP, ensuring current insurance premium reserves created by those that did buy coverage before events, and expand compliance and mitigation in the future.

2. NFIP Authorization

PIA National firmly believes that the NFIP must continue to have multi-year authorization by Congress for its various authorities in order to operate a balanced, orderly program with continuity.

A five-year authorization is attainable and desirable for the program's sake and fully responsive to Congress' evaluation obligations.

This position is unanimously adopted by all member-organizations of FIPNC, and one supported by PIA national policy.

Congressional and NFIP Monies

Administration/Operating Costs: Monies earmarked for NFIP administration by Congress should be exclusively secured and retained for NFIP's direct expenses and maintenance. Monies for these purposes will be a combination of a portion of the insurance premiums costs paid by policyholders – and – Congressional budget appropriations.

NFIP should not have its entire year-to-year "agency" operating/administrative costs born by the NFIP policyholders, because as a federal program, there are unique costs that are the pure and particular costs of running the Federal Government. No other class of "benefits" recipients of any federal government program for any agency bears that full "agency administrative costs load" in their program – nor should they.

Additionally, monies to support FEMA/FIMA and their agency role in the Department of Homeland Security should not come from NFIP monies secured, authorized or collected for purposes to direct NFIP programs, especially when they are monies from the reserve accounts. These should be included in the portion of FEMA/NFIP annually appropriated administrative monies.

PIA National appreciates that Congress must be prudent, but realistic as to the costs of both running and supporting the NFIP. Therefore, the extraordinary expenses that FEMA for NFIP is currently bearing for an extraordinary event, the scope of which could not be realistically imagined, should come from the federal disaster relief monies being provided FEMA in future events.

Secured Premium Reserves: Further, the NFIP insurance premiums paid by property owners to insure for flooding should be paid into and *secured* in reserve *to include* the interest income earned on those premium monies, and *only* used for purposes directly related to NFIP flood loss events. Congress or non-direct NFIP FEMA operations and/or Department of Homeland Security should not bleed off *any* of these funds (to include interest) for use as offsets to the annual federal budget appropriations deficit in the portion of NFIP operation dollars, or other uses. This unfortunately has been an issue over the years, leaving NFIP premium reserves appearing insufficient in the face of "normal" major flooding events.

At those times when Congress has "tapped the NFIP reserve till," it viewed NFIP premium account monies as "over-reserved." When created, Congress understood that the NFIP was designed to operate more than not as a traditional insurance program, collecting and reserving monies for flood events. As such, it is a given that some years will result in the cost of flood claims exceeding the premium collected that year, and perhaps the reserves at hand. However, there will be other years where flood losses will be low, giving the premium reserve and interest income account time to grow. Unlike private sector insurers, NFIP has no "other " insurance premium reserves from which to draw from when claims events exceed the specific coverage line reserves collected.

Current deficiencies in NFIP premium reserves-to-covered flood events payouts would be far less dramatic had NFIP former reserves not been tapped to offset basic agency-program operating costs. Congress significantly decreased FIMA's ongoing regular administrative costs. The unambiguous inference/suggestion to FIMA was that the NFIP "over-reserved" premiums could be diverted as the source for agency administrative funds shortfall.

All members and their respective organizations of FIPNC also support these positions.

Lessons Learned Must be Acted Upon

Private Sector Property Policy vs. NFIP: If there is one general area that must be reviewed, it is: How different from private sector insurance property coverages (to include their meaning and practice) should the NFIP insurance policies, coverages, meanings and practices be? While there are many items PIA National would suggest – the following are a few of the major considerations at this time:

(1) NFIP building property insurance limits maximums for all classes of property able to be insured must be increased. Current limits are increasingly inadequate and with today's values and adjusting for inflation since 1968, provide less real dollar coverage.

(2) For non-commercial properties, PIA National strongly suggests that NFIP consider including automatic coverage for contents per some percentage of the building amount insured for flood. Currently, building/residence contents are not covered in an NFIP policy unless the insured specifically decides to include that coverage and cost in their NFIP policy. Most all in the NFIP program have building coverage, but fewer than should have contents coverage, electing instead to "save their money." However when a loss ensues, people forget and confuse the manner in which private sector homeowners insurance responses to a loss (building value covered automatically sets 50% of that for contents, 10% for outer structures and 20% for additional living expenses) with how NFIP insurance really works. Consumers' claims settlement expectation is that contents will be covered as a percentage of the building value covered. And when that does not happen, issues may arise from their disappointment.

(3) NFIP should consider adding or coordinating flood coverage for commercial policies in the area of business interruption insurance. BII coverage is now only available in the private sector property market on a covered peril basis. Flood is not a covered peril in the private sector, and thus in Katrina/Rita businesses, especially small-to-mid-size owners who purchased the coverage as a part of their Business Owner Policy in the private sector were not able to have the coverage apply to their ongoing business cost needs in the flooding aftermath.

(4) Separating Insurance from Government Assistance: PIA National never forgets that NFIP is a federal program, and as such may be subject to and need to consider federal government assistance for specific limited areas with buildings and property owners that require NFIP coverage, but may have mitigation and/or true needs-affordability issues. Congress will, as always, decide who, what, where and when. However, when those are identified and Congress decides to make these rare accommodations that should be understood clearly as exceptions, this should not drive changes in the overall NFIP program/operations, but be dealt and managed as NFIP matters would regularly – and then have the government assistance applied to those exceptions cases – nothing their uniqueness.

In a comprehensive NFIP program, where the rules are consistently applied, there will be some property owners that will fall into federal government needs testing when the regular NFIP premium is calculated for their properties. In these circumstances, the NFIP premiums should stand, but these individuals should receive the government assistance decided by Congress to help offset their NFIP costs.

Similarly, there may be certain long-term critical housing or historic properties that have long-stood in flood designated areas, and in Congress' view be permitted to have special exceptions granted. Again, these would be designated as such in NFIP so that Congress does not confuse their special treatments with the balance of the regular NFIP program.

Such are the exceptions one must reasonably expect and provide for in a government program. However, these neither are nor ever should be the exceptions that drive the final nature of program-wide changes to NFIP.

NFIP- States and Municipal Governments
State and municipal governments must:

1. Work with the NFIP (FEMA/FIMA) to more thoroughly assure their understanding of and support for the technical needs of NFIP risk management.

2. Work with the federal government to update mutual property/zone mapping responsibilities and results. State and local governments have just as much invested in the accuracy and access to such maps – traditional to the duty and control of local authorities.

3. Work with survey employees, independent firms and independent contractors to be up to date on what the elements on the elevation certificate mean, how they need to be secured, why their professional signed opinion is necessary,

and determine causes of the extraordinary spike in elevation certificate expenses being passed on to consumers.

4. In addition, PIA believes that the flood requirements of the NFIP Elevation Certificate should become a normal and regular part of the official property recordings for plot/pre-building/final site public filing. With this, communities should also forge an increased working partnership with flood plain mangers to more completely follow their guidance on building issues as they relate to flood. These would combine to make moot the current NFIP elevation certificate as a unique and separate process. Instead, communities would be imposing flood compliance in their regular property activities from the first step, requiring all land use and projects to meet or exceed Base Flood Elevation. These were the original goals of the NFIP process.

5. Identify the infrastructure improvements required in their state for flood prevention structures such as – levy, dikes, canals, over-spills and others, and work with federal agencies to secure joint-funding.

6. Work on evolved, improved flood plain management emerging issues such as the alarming increase in the number of LOMRs, LOMAs and such that are being approved. An increasing number of these may pass local "landfill" requirements. However, many of those requirements were set for sanitation/pollution/contamination concerns and do not sufficiently address flood-worthiness standards. Additionally, some of these exceptions are secured based upon vacant land use that does not conceive the future use to which the land may be placed.

7. Work out a more successful approach to the use, protection and flood-recovery for certain lands/properties that pre-date and/or are by other means grandfathered by the NFIP program and its terms.

PIA appreciates that such locations are believed to have significant value or meaning to the history, the economy or homestead needs of an area and its populations. However, the number of lands and properties in these classes must remain limited by their very nature. Their treatment under NFIP/federal disaster needs must be addressed from the perspective of a government benefit program.

PIA asks that Congress no longer place FEMA/FIMA, NFIP and/or the insurance participants in a "no-win" position.

Currently, the difficulties are that on the one hand, Congress expects NFIP to treat such exceptions as "regular insuring prospects" to be underwritten, rated and serviced as all other properties under NFIP. PIA does not believe that they can ever be treated as such, and many times should not be treated as such. On the other hand, Congress responds with confusion and anger when such properties are identified and treated as the significant flood-exposed uninsurable properties they are under the traditional application of NFIP standards. This is at the same time that Congress laments the number of repetitive flood-loss payouts.

Insurance Sector and FEMA/FIMA - Recommendations

1. Having worked with FEMA on the development of NFIP Continuing Education guidelines, PIA National with Rita Hollada, our national NFIP representative, we are completing a series of educational offerings with and for PIA members in conjunction with our PIA affiliates. In addition to insurance producers, PIA National believes many more persons involved with the NFIP program (to include FEMA employees) should participate in the CE offerings that meet FEMA guidelines, because knowledge about the NFIP is all of our collective responsibility.

2. Continue to resolve needed improvements in the areas of policy form language, underwriting procedures, rating and claims services.

3. Increase coordination and compatibility between/among NFIP, insurance and lender evaluations of properties.

4. Continue to work on finding solutions to a growing number of conflicts between federal legal views and framework of the NFIP verses related specific areas under state law.

5. Respond to the reasonable level of carrier reimbursement for the usual and required expenses of the NFIP. These levels should, as they are, be subject to pre-set standards and periodic review and when needed adjustment. However, limiting or decreasing these reimbursements as federal cost-saving mechanisms cannot be allowed.

Insurance Agents and Carriers – Recommendations

PIA encourages its members to actively write flood insurance coverage for their clients or know through their carriers or association programs quality agencies that write this business and to which they can refer their clients.

1. In doing so, agents should exercise their internal Errors & Omissions procedures to document the discussions about flood insurance, the fact that coverage was offered or a referral was made, and with the consumer/client document the client's acceptance or decline of this offer.

2. Carriers and agents should write a lot of this business or know a qualified local agent that does to direct their customers to.

3. PIA supports Departments of Insurance granting continuing education credits (CE) for both in-classroom, long-distance, and qualified self-study courses for flood insurance.

4. Carriers and vendors that write NFIP business through and with insurance producers must take (as many do but not all) an active role in providing quality underwriting, rating, processing and claims service, as well as coverage/practice education to their producers on flood insurance.

5. These education programs must be directed by qualified instructors that understand both the NFIP program *and* the traditional private sector insurance property coverage and legal environment in which flood insurance coverage, producers, carriers, lenders, determination companies, surveyors, flood plan managers and others find themselves.

Coordination with Related Programs

PIA National believes that the NFIP is the appropriate structure for insuring flood losses. Going forward, Congress may consider a comprehensive, coordinated natural disaster catastrophe program. The widespread devastation caused by Hurricane Katrina serves as an awesome reminder that neither one state nor a regional grouping of states can fund or support a catastrophe reserve fund. In September 2005 PIA National again outlined the elements of such a proposal and urged Congress to enact it. We point out here that such a catastrophe funding mechanism should neither encompass nor subsume the NFIP. Additionally, PIA National is on record strongly supporting extension of the Terrorism Risk Insurance Act (TRIA). We believe TRIA must be extended, but that it must be treated as it is now – a specific, distinct program that cannot be paired with a natural disaster catastrophe program or the NFIP.

Conclusion

PIA hopes that by working together with the many private sector groups, public interest entities, together with local, state and federal government agencies and Congress, our suggestions for NFIP's improvements will continue to support and improve this vital, needed federal program.

Certainly, the outline developed for the internal review/study of the NFIP provides all of us with a starting point for these ongoing discussions. Our comments here connect PIA's knowledge to the related areas in the suggested NFIP study outline that Congress has requested.

PIA looks forward to expanding our continuing working efforts with NFIP parties at interest, to Congress and the vendors for the NFIP study.

NATIONAL FLOOD INSURANCE PROGRAM
Estimate of Ultimate Paid Losses from Hurricane Rita

	Total PIF	Total Coverage	Assumed Frequency	Estimated # Claims	Assumed Severity	Estimated $ Paid
Counties most impacted by Rita						
Lousiana Parishes[1]						
Acadia	2,197	157,234,000	10.0%	220	$ 30,000	$ 6,600,000
Calcasieu[2]	7,743	956,075,900	40.0%	3,097	$ 75,000	$ 232,275,000
Cameron[3]	1,456	152,556,600	50.0%	728	$ 80,000	$ 58,240,000
Iberia	2,632	339,297,500	10.0%	263	$ 50,000	$ 13,150,000
Jefferson Davis	710	69,319,800	10.0%	71	$ 40,000	$ 2,840,000
Lafayette[4]	9,180	1,289,897,500	5.0%	459	$ 55,000	$ 25,245,000
St. Martin	1,478	164,925,400	10.0%	148	$ 45,000	$ 6,660,000
St. Mary	4,474	537,529,000	10.0%	447	$ 50,000	$ 22,350,000
Terrebonne	11,807	1,532,898,500	25.0%	2,952	$ 50,000	$ 147,600,000
Vermilion	3,185	294,480,000	10.0%	319	$ 40,000	$ 12,760,000
LA Totals	44,862	5,494,214,200		8,704	$ 60,630	$ 527,720,000

[1] Average Severity is based on 40% of the average amount of insurance unless otherwise noted.
[2] Average Severity is based on 60% of the average amount of insurance.
[3] Average Severity is based on 90% of the average amount of insurance.
[4] Lafayette Parish was previously ravaged by Katrina, so we assume a much lower frequency for Rita.

	Total PIF	Total Coverage	Assumed Frequency	Estimated # Claims	Assumed Severity	Estimated $ Paid
Texas Counties[5]						
Galveston	54,325	10,049,495,100	1.0%	543	$ 26,000	$ 14,118,000
Jefferson	17,898	3,221,006,600	11.0%	1,969	$ 25,000	$ 49,225,000
Orange	5,754	878,832,800	6.0%	345	$ 21,000	$ 7,245,000
Other Affected Areas	8,549	1,539,883,000	1.0%	85	$ 25,000	$ 2,125,000
TX Totals	86,526	15,689,217,500		2,942	$ 24,715	$ 72,713,000

[5] Average Severity is based on 14% of the average amount of insurance.

Rita - Building and Contents Losses	11,646	$ 51,557	$ 600,433,000
Rita - Provision for ICC[6] Claims			$ 18,012,990
Provision for Loss Adjustment Expenses			$ 48,238,787
TOTAL Liability for Losses and Loss Adjustment Expenses			**$ 666,684,777**

[6] Increased Cost of Compliance coverage

October 17, 2005

NATIONAL FLOOD INSURANCE PROGRAM
Estimate of Ultimate Paid Losses from Hurricane Katrina

	Total PIF	Total Coverage	Assumed Frequency	Estimated # Claims	Assumed Severity	Estimated $ Paid
Counties most impacted by Katrina						
Alabama						
Baldwin County	20,423	3,185,594,800	30.0%	6,127	$ 80,000	$ 490,160,000
Mobile County	6,877	1,082,665,900	30.0%	2,063	$ 80,000	$ 165,040,000
Mississippi						
Hancock County	5,462	739,082,600	70.0%	3,823	$ 90,000	$ 344,070,000
Harrison County	10,218	1,569,645,100	70.0%	7,153	$ 90,000	$ 643,770,000
Jackson County	5,913	890,349,100	70.0%	4,139	$ 90,000	$ 372,510,000
Lousiana						
Jefferson Parish[1]	110,258	17,231,143,900	66.7%	73,505	$ 75,000	$ 5,512,875,000
Lafayette Parish[2]	9,180	1,289,897,500	50.0%	4,590	$ 75,000	$ 344,250,000
Lafourche Parish[2]	9,334	1,070,954,700	50.0%	4,667	$ 75,000	$ 350,025,000
Orleans Parish[3]	85,771	12,699,150,500	77.5%	66,473	$100,000	$ 6,647,300,000
Plaquemines Parish[3]	5,099	790,362,800	75.0%	3,824	$100,000	$ 382,400,000
St. Bernard Parish[3]	15,823	2,185,079,000	75.0%	11,867	$100,000	$ 1,186,700,000
St. Tammany Parish[2]	37,286	7,191,114,100	50.0%	18,643	$ 75,000	$ 1,398,225,000

[1] Average Severity is based on 25% of claims being paid policy limits with the remaining claims having a $50,000 severity
[2] Average Severity is based on 25% of claims being paid policy limits with the remaining claims having a $40,000 severity
[3] Average Severity is based on 50% of claims being paid policy limits with the remaining claims having a $50,000 severity

	Total PIF	Total Coverage	Assumed Frequency	Estimated # Claims	Assumed Severity	Estimated $ Paid
Florida						
South FL Counties	910,933	159,150,128,000	1.5%	13,664	$ 22,500	$ 307,440,000
Escambia County	14,681	2,750,764,500	15.0%	2,202	$ 50,000	$ 110,100,000
Okaloosa County	18,085	3,092,233,600	5.0%	904	$ 35,000	$ 31,640,000
Santa Rosa County	8,183	1,930,472,900	10.0%	818	$ 40,000	$ 32,720,000
Counties with Low to Moderate Flooding	114,822	16,722,385,800	10.0%	11,482	$ 20,000	$ 229,640,000
Katrina - Building and Contents Losses				235,944	$ 78,616	$ 18,548,865,000
Katrina - Provision for ICC[4] Claims						$ 2,062,813,719
Provision for Loss Adjustment Expenses						$ 1,607,710,940
TOTAL Liability for Losses and Loss Adjustment Expenses						**$ 22,219,389,659**

[4] Increased Cost of Compliance coverage

October 17, 2005

Projection of the Federal Cash Flow from NFIP Claims Payments for Hurricanes Katrina and Rita

Month End	Dollars Paid and Presented for LOC Drawdowns by the WYO Companies						Total Paid & Presented for LOC Draws ($M)	Interest on Borrowing ($M)	**Net Fund Balance ($M)**
	Hurricane Katrina				Hurricane Rita				
	New Orleans Area		Remainder of Katrina						
	% of Ult	Cum ($M)	% of Ult	Cum ($M)	% of Ult	Cum ($M)			
Aug-05	0.0%	$0	0.1%	$6			$6		**($36)**
09/04 - 09/10	0.0%	$0	0.3%	$17			$17		**($48)**
09/11 - 09/17	0.1%	$16	0.6%	$35			$51		**($81)**
09/18 - 09/24	0.2%	$25	1.1%	$64			$88		**($118)**
09/25 - 09/30	0.4%	$66	1.8%	$101	0.1%	$1	$167	$2	**($200)**
10/01 - 10/07	0.8%	$123	4.0%	$231	0.4%	$3	$357		**($389)**
10/08 - 10/14	1.6%	$263	7.0%	$404	1.0%	$7	$674		**($706)**
10/15 - 10/21	3.0%	$493	12.0%	$693	3.0%	$20	$1,206		**($1,239)**
10/22 - 10/31	6.5%	$1,069	17.0%	$981	5.0%	$33	$2,084		**($2,116)**
11/01 - 11/04	11.0%	$1,809	22.0%	$1,270	8.0%	$53	$3,133		**($3,165)**
11/07 - 11/11	15.5%	$2,549	27.0%	$1,559	11.0%	$73	$4,181		**($4,214)**
11/14 - 11/18	20.0%	$3,289	32.0%	$1,847	15.0%	$100	$5,237		**($5,269)**
11/21 - 11/30	24.5%	$4,029	37.5%	$2,165	19.0%	$127	$6,321		**($6,353)**
Dec-05	38.0%	$6,250	60.0%	$3,464	40.0%	$267	$9,980		**($10,013)**
Jan-06	52.0%	$8,552	72.5%	$4,186	72.5%	$483	$13,221		**($13,253)**
Feb-06	67.0%	$11,019	79.0%	$4,561	80.0%	$533	$16,113		**($16,146)**
Mar-06	75.0%	$12,335	83.0%	$4,792	85.0%	$567	$17,693	$200	**($17,926)**
Apr-06	79.0%	$12,992	85.0%	$4,907	88.0%	$587	$18,486		**($18,719)**
May-06	81.5%	$13,404	86.0%	$4,965	91.0%	$607	$18,975		**($19,208)**
Jun-06	84.5%	$13,897	87.5%	$5,052	93.0%	$620	$19,569		**($19,801)**
Jul-06	87.5%	$14,390	89.0%	$5,138	95.0%	$633	$20,162		**($20,395)**
Aug-06	90.0%	$14,801	90.5%	$5,225	96.0%	$640	$20,666		**($20,899)**
Sep-06	92.0%	$15,130	92.0%	$5,311	97.0%	$647	$21,089	$487	**($21,809)**
Mar-07	96.0%	$15,788	96.0%	$5,542	98.5%	$657	$21,987	$534	**($23,241)**
Sep-07	100.0%	$16,446	100.0%	$5,773	100.0%	$667	$22,886	$570	**($24,710)**
Ultimate	100.0%	$16,446	100.0%	$5,773	100.0%	$667	$22,886		

NOTES:
- In addition to paying for Katrina and Rita, the Fund will have premium income and will pay for flood losses from other events. For purposes of this exhibit, the net effects of this other income and expenses on the Fund Balance are minor compared to these two hurricanes.
- The bulk of ICC claims payments will be made in FY 2007.

October 17, 2005