

Committee on Resources

Subcommittee on Fisheries Conservation, Wildlife and Oceans

Statement

TESTIMONY OF

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BEFORE THE

SUBCOMMITTEE ON FISHERIES CONSERVATION,

WILDLIFE AND OCEANS

COMMITTEE ON RESOURCES

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My name is Jo Ann Howard, and I am Administrator of the Federal Insurance Administration, which is the arm of FEMA that is responsible for the insurance component of the National Flood Insurance Program (NFIP). I appreciate the opportunity today to outline the financial condition of the National Flood Insurance Fund and the effect that the Coastal Barrier Resources Act has had on the Fund.

Let me first give a little background on the NFIP. The NFIP was launched in 1968 to foster safer flood plain development decisions and to provide an insurance alternative to Federal disaster assistance for those who suffer financial loss due to flooding. One of the program's cornerstones is an agreement between the Federal government and the local community. This agreement makes flood insurance available at less than full risk rates for properties built before safer building standards were in place in exchange for the community's commitment to ensure that new structures are built to these safer standards. New buildings are insured at actuarial rates, meaning that the premiums paid on these buildings reflect their actual flood risk.

The fact that existing buildings in the flood plain are insured at less than full risk rates does not mean that the insurance is cheap. During the early years of the program it was. However, beginning in 1981, the NFIP initiated a series of rate increases to make the program self-supporting for the average historical loss year, so that enough premiums would be collected each year to pay for losses. We achieved that goal in 1986. The net effect of the rate increases was that while owners of existing structures in the flood plain were not required to pay full risk premiums, they were asked to assume a larger portion of their post-flood loss costs. Right now, the average annual premium

for these existing structures is about \$560, whereas the average for new structures paying actuarial premiums is \$270.

However, this \$560, substantial though it is, is still inadequate, because the full risk premium for these properties is about \$1300. This is what is loosely referred as the program "subsidy." With about 30 percent of the 4.1 million properties insured by the NFIP in this class, the program experiences an annual shortfall in premium of about \$500 million. This shortfall is not offset by any infusion of funds from elsewhere. It simply prevents the program from accumulating any reserves and requires the program to borrow from the Treasury when we experience a series of higher than average loss years, as we did in the mid-90's. Right now, the program owes the Treasury \$730 million. However, this \$730 million must be viewed in the context of the NFIP having paid over \$6 billion in losses out of policyholder premiums since 1986.

Furthermore, within the design of the program, this "subsidy" for existing properties was regarded, especially in the early years of the program, as an investment in the future, the return on investment being safer new floodplain construction. If these existing structures had not been made eligible for affordable coverage, communities would not

have had the necessary incentive to enact the ordinances to regulate new construction. This incentive has clearly worked, as 19,000 communities now participate in the NFIP and enforce safer standards for new floodplain construction. Overall, buildings constructed to program standards suffer 77 percent less damage over the life of the structure based on our loss experience. We estimate that the enforcement of building ordinances meeting NFIP standards results in about \$800 million in lower annual damage due to flooding.

That is not to say that this subsidy for existing structures should continue. The 1994 National Flood Insurance Reform Act called for a study to examine the effect of reducing or eliminating the subsidy. We are now in the process of analyzing the findings of that study and we will be looking at where subsidy reduction can be accomplished. We are especially concerned about secondary homes and certain recreational properties.

One of our current initiatives targets those properties that are flooded repeatedly, i.e. twice or more in a ten-year period, resulting in loss payments significantly out of proportion to their number. These are a subset of the 1.2 million "subsidized" properties described above, and they number about 40,000, with the worst of them totaling about 9,000. These 9,000 properties have suffered four losses or been paid multiple claims cumulatively exceeding the property value. Over the years, repetitively damaged properties have accounted for over a third of the program's total losses. Most of these properties are in riverine flood plains, with only 3.5 percent of them in coastal high hazard areas.

We have developed a strategy to address these problem properties by using monies available through FEMA's Hazard Mitigation Grant Program and the Flood Mitigation Assistance Program to offer assistance in either moving or elevating them. If the owners elect not to accept such an offer, we propose charging full actuarial premiums for continued coverage.

How the Coastal Barrier Resources System affect the financial condition of the flood insurance fund is difficult to assess. As an example, currently only about 2 percent of all NFIP policies are in coastal high hazard areas (V zones), and CBRA properties ineligible for insurance represent only a small portion of these areas. Furthermore, as I noted before, our loss experience depends on when a structure was built. The structures built to NFIP standards suffer far less damage than those built before the standards were in place. This is the case in all high-risk zones, including V zones. Through calendar year 1997, the experience period examined in our latest annual rate review conducted in 1998, V zone buildings constructed since 1981 and subject to NFIP standards have had a combined loss and expense ratio of .59. The result of this very favorable ratio is a \$45 million operating surplus. It is this age group of buildings that includes those ineligible for insurance in CBRA areas. On the other hand, V zone buildings constructed prior to the implementation of program standards, the group that includes those still eligible for insurance in CBRA areas, produced an operating deficit of \$126 million.

None of this is to minimize the serious risk to which these coastal properties are exposed, and any given storm, depending on where it strikes, could devastate these areas. So there are undoubted benefits to be derived from limiting new construction on vulnerable coastal barrier islands. In fact, our experience in disaster response and recovery would suggest that CBRA has had a significant role in reducing disaster costs associated with rebuilding infrastructure, debris removal, and other costs. Furthermore, limiting our insurance exposure in these areas limits the NFIP's exposure to a volatile set of properties, although they represent a relatively small potential portion of our entire book of business. It is very difficult, however, to assess the impact of CBRA legislation on the flood insurance fund and the cost of flood insurance given that it is based on what we cannot insure and for which, therefore, we have no underwriting experience to review.

Because the prohibition of Federal expenditures in Coastal Barrier Resources System (CBRS) areas includes prohibiting the sale of NFIP flood insurance for many structures, it is imperative that the NFIP flood hazard maps reflect these areas. NFIP maps are used over 11 million times annually by mortgage lenders to determine the statutory need for borrowers to obtain flood insurance and by insurance agents to rate flood insurance policies. The accurate portrayal of CBRS boundaries is therefore critical to ensure that erroneous policies are not issued. I am gratified that the CBRA reauthorization bill includes a provision to digitize the boundary of the CBRA areas. This is an important new technology and consistent with the direction FEMA is taking in efforts to modernize and update its flood hazard-mapping program.

Since 1982, FEMA has invested approximately \$1,300,000 to update approximately 2100 NFIP panels--to add or revise CBRS areas to NFIP maps. These expenditures have come entirely from the NFIP flood mapping budget, which presently comes from a \$30 Federal Policy Fee charged to all flood insurance policyholders. The fundamental tenet of the NFIP flood-mapping program is to develop and provide up-to-date flood hazard data to participating communities. Because a portion of the limited flood mapping budget has been diverted to delineate CBRS areas on NFIP maps, FEMA has had to defer or postpone needed flood data updates for some of its participating communities. Since the NFIP is one of the principal users and implementation arms of the Act, I would propose that there continue to be close coordination between FEMA and the Department of Interior on the production of the maps. I would also ask that consideration be given to providing funds to FEMA as well to incorporate CBRA information into flood insurance maps.

I hope I have been helpful in your deliberations. I will be happy to answer any questions you might have.

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