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**FEDERAL EMERGENCY
MANAGEMENT AGENCY**

**Ongoing Challenges Facing
the National Flood
Insurance Program**

Statement of Orice Williams, Director
Financial Markets and Community Investments





Highlights of [GAO-07-118T](#), a testimony before the Committee on Banking, Housing and Urban Affairs, U.S. Senate

Why GAO Did This Study

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.

Given the challenges facing the NFIP and the need for legislative reform to ensure the financial stability and ongoing viability of this program, GAO placed the NFIP on its high-risk list in March 2006. This testimony updates past work and provides information about ongoing GAO work on issues including (1) NFIP's financial structure, (2) the extent of compliance with mandatory requirements, (3) the status of map modernization efforts, and (4) FEMA's oversight of the NFIP.

Building on our previous and ongoing work on the NFIP, GAO collected data from FEMA to update efforts, including information about claims, policies, repetitive loss properties, and mitigation efforts.

What GAO Recommends

In past work, GAO recommended that FEMA strengthen its oversight of the NFIP and insurance companies responsible for selling and servicing flood policies, among other things. FEMA generally agreed with our recommendations.

To view the full product, including the scope and methodology, click on [GAO-07-118T](#). For more information, contact Orice M. Williams at (202) 512-8678 or williamso@gao.gov.

FEDERAL EMERGENCY MANAGEMENT AGENCY

Ongoing Challenges Facing the National Flood Insurance Program

What GAO Found

The most significant challenge facing the NFIP is the actuarial soundness of the program. As of August 2007, FEMA owed over \$17.5 billion to the U.S. Treasury. FEMA is unlikely to be able to pay this debt, primarily because the program's premium rates have been set to cover an average loss year, which until 2005 did not include any catastrophic losses. This challenge is compounded by the fact that some policyholders with structures that were built before floodplain management regulations were established in their communities generally pay premiums that represent about 35 to 40 percent of the true risk premium. Moreover, about 1 percent of NFIP-insured properties that suffer repetitive losses account for between 25 and 30 percent of all flood claims. FEMA is also creating a new generation of "grandfathered" properties—properties that are mapped into higher-risk areas but may be eligible to receive a discounted premium rate equal to the nonsubsidized rate for their old risk designation. Placing the program on a more sound financial footing will involve trade-offs, such as charging more risk-based premiums and expanding participation in the program.

The NFIP also faces challenges expanding its policyholder base by enforcing compliance with mandatory purchase requirements and promoting voluntary purchase by homeowners who live in areas that are at less risk. One recent study estimated that compliance with the mandatory purchase requirement was about 75 to 80 percent but that penetration elsewhere in the market was only 1 percent. Since 2004, FEMA has implemented a massive media campaign called "FloodSmart" to increase awareness of flooding risk nationwide by educating everyone about the risks of flooding and encouraging the purchase of flood insurance. While the numbers of policyholders increased following Hurricane Katrina, it is unclear whether these participants will remain in the program as time goes on.

The impact of the 2005 hurricanes highlighted the importance of up-to-date flood maps that accurately identify areas at greatest risk of flooding. These maps are the foundation of the NFIP. In 2004 FEMA began its map modernization efforts, and according to FEMA, about 34 percent of maps have been remapped. Completing the map modernization effort and keeping these maps current is also going to be an ongoing challenge for FEMA.

Finally, FEMA also faces significant challenges in providing effective oversight over the 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. As GAO recommended in an interim report issued in September 2007, FEMA needs to take steps to ensure that it has a reasonable estimate of actual expenses that the insurance companies incur to help determine whether payments for services are appropriate and that required financial audits are performed. GAO, in its ongoing work, plans to further explore FEMA oversight of the private insurance companies and the cost of selling and servicing NFIP flood policies.

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program (NFIP) and the challenges facing the Federal Emergency Management Agency (FEMA), which oversees it. As you know, the NFIP has been on GAO's high-risk list since March 2006, and my statement today focuses on the ongoing challenges facing the program. Over the past three decades, we have identified numerous challenges to the program that affect its day-to-day operations and future financial stability. Recently, we reported on NFIP's unprecedented financial and regulatory strains in the aftermath of the 2005 hurricane season.¹ As a result, the program has had to borrow extensively from the U.S. Treasury in order to pay claims and expenses. With the current program expiring next September, this and other issues warrant review and debate, including how best to structure the NFIP so that it provides financial protection for those who need and would benefit from flood insurance while enhancing the program's financial foundation.

My testimony today will revisit and update the four major challenges facing the NFIP:

- Reducing losses to the program from policy subsidies and repetitive loss properties—that is, properties in high-risk areas that flood repeatedly and that make repeated claims on the NFIP;
- Increasing property owner participation in the program to include not only homeowners in high-risk areas, but also those who live in less flood-prone areas that are still at risk of experiencing losses from flooding;
- Developing accurate, digital flood maps that can provide the information the program needs to determine which areas are most at risk of flooding; and
- Providing effective oversight of flood insurance operations to ensure that the NFIP is making appropriate payments to the insurance companies, insurance agents, and claims adjusters responsible for the day-to-day process of selling and servicing flood insurance policies.

¹GAO, *National Flood Insurance Program: New Process Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved*, [GAO-07-169](#) (Washington, D.C.: Dec. 15, 2006).

My statement is based largely on completed work on the 2005 claims process and subsequent payments to insurance companies for services rendered and ongoing work on subsidized properties; the rate-setting process for flood insurance premiums; financial and statistical information on the NFIP from a variety of sources; and the Write-Your-Own (WYO) program, under which insurance companies enter into agreements with FEMA to sell and service flood insurance policies and adjust claims after flood losses; and FEMA's oversight. In conducting our work, we collected relevant data from FEMA; analyzed statutes, regulations, and payment data relevant to the NFIP; and interviewed FEMA officials, FEMA contractors, insurance company officials, and state and local officials to obtain information relevant to their experience with NFIP. Some of the work was also based on interviews with individual policyholders, insurance agents, and claims adjusters, and on audits of private insurance companies that sell and service flood insurance on behalf of FEMA. We performed our work in accordance with generally accepted government auditing standards.

In summary:

One of the biggest challenges facing the NFIP is the actuarial soundness of the program. As of August 2007, FEMA owed over \$17.5 billion to the U.S. Treasury, largely resulting from losses during the 2005 hurricanes. FEMA is unlikely to be able to pay this debt primarily because many of the program's premium rates have been set to cover losses in an average historical year based on program experience that did not include any catastrophic losses. To keep the cost of flood insurance affordable, Congress included premium subsidies, and as a result the program does not take in as much in premiums as it pays out in claims. With these subsidies, some policyholders with structures that were built before floodplain management regulations were established in their communities pay premiums that represent about 35 to 40 percent of the true risk premium. Moreover, about 1 percent of NFIP-insured properties that suffer repetitive losses account for between 25 and 30 percent of all flood claims. FEMA is also creating a new generation of "grandfathered" properties that are mapped into higher-risk areas and that have an existing policy or purchase a new flood insurance policy prior to the adoption of new maps. The properties may be eligible to receive a discounted or "grandfathered" premium rate equal to the nonsubsidized rate for their old risk designation. Placing the program on more sound financial footing will involve trade-offs in how best to balance the need for charging higher premiums, which would put the program on a sounder financial basis while continuing to encourage participation in the program.

The NFIP also faces challenges expanding its policyholder base by enforcing compliance with mandatory purchase requirements and promoting voluntary purchase by other homeowners, some of whom live in areas that are at less risk. While flood insurance is mandatory for homeowners who live in certain high-risk areas and have mortgages held by federally regulated financial institutions, determining the extent of compliance can be complicated. One recent study estimated that compliance with the mandatory purchase requirement was about 75 to 80 percent but that the penetration elsewhere in the market was only 1 percent. Moreover, since 2004, FEMA has implemented a mass media campaign called “FloodSmart” to educate the public about the risks of flooding and to encourage the purchase of flood insurance. While the numbers of policyholders has increased following Hurricane Katrina, it is unclear whether these policyholders will remain in the program as time goes on.

The impact of the 2005 hurricanes highlighted the importance of having accurate, up-to-date flood maps that identify areas that are at risk of flooding and thus the areas where property owners would benefit from purchasing flood insurance. While requirements for purchasing flood insurance apply only to certain properties in high-risk areas, according to FEMA about half of all flood damage occurs outside of areas currently mapped as high-risk areas. In response to recommendations from Congress, GAO, and others, FEMA has taken steps to adjust its map modernization efforts by changing its mapping standards and guidelines and adjusting risk-based mapping priorities. However, managing its relationship with its contractor and with state and local partners—all with varying technical capabilities and resources—to produce accurate digital flood maps is an ongoing challenge. Likewise, assuring that map standards are consistently applied across communities once the maps are created is a similar challenge.

FEMA, which oversees the NFIP program, also faces significant challenges in providing effective oversight over the insurance companies and thousands of insurance agents and claims adjusters that are primarily responsible for the day-to-day process of selling and servicing flood insurance policies. In response to our recommendations an interim report issued in September 2007, FEMA has agreed to take steps to ensure that it has a reasonable estimate of the actual expenses the insurance companies

incur to help determine whether payments for services are appropriate and to ensure that required financial audits are performed.²

Background

The NFIP provides property insurance for flood victims, maps the boundaries of the areas at highest risk of flooding, and offers 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 is needed for the NFIP to achieve its goals. These include:

- providing property flood insurance coverage for the many property owners who would benefit from such coverage;
- reducing taxpayer-funded disaster assistance for property damage when flooding strikes; and
- reducing flood damage to properties through floodplain management that is based on accurate, useful flood maps and the enforcement of relevant building standards.

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. Our analysis of FEMA data found that over the past 25 years, about 97 percent of the U.S. population lived in a county that had at least one declared flood disaster, and 45 percent lived in a county that had six or more flood disaster declarations.³ However, flooding is generally excluded from homeowner insurance policies that typically cover damage from other losses, such as wind, fire, and theft. Because of the catastrophic nature of flooding and the difficulty of adequately predicting flood risks, as well as the fact that those who are most at risk are the most likely to buy coverage, private

²GAO, *National Flood Insurance Program: FEMA's Management and Oversight of Payments for Insurance Company Services Should Be Improved*, [GAO-07-1078](#) (Washington D.C.: Sept. 5, 2007).

³GAO, *Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework*, [GAO-07-403](#) (Washington, D.C.: Aug. 22, 2007).

insurance companies have largely been unwilling to underwrite and bear the risk of flood insurance.⁴

The NFIP was established by the National Flood Insurance Act of 1968 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.⁵ In creating the NFIP, Congress found that a flood insurance program with the “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.”⁶ In keeping with this purpose, 92 private insurance companies were participating in the WYO program as of September 2007. NFIP pays these insurers fees to sell and service policies and adjust and process claims. FEMA, which is within the Department of Homeland Security (DHS), is responsible for the oversight and management of the NFIP. We reported in September 2007 that about 68 FEMA employees, assisted by about 170 contract employees, manage and oversee the NFIP and the National Flood Insurance Fund, into which premiums are deposited and claims and expenses are paid. As of April 2007, the NFIP was estimated to have over 5.4 million policies in about 20,300 communities.⁷ To ensure that NFIP can cover claims after catastrophic events, FEMA has statutory authority to borrow funds from the Treasury to keep the program solvent.⁸

According to FEMA, an estimated \$1.2 billion in flood losses are avoided annually because communities have implemented the NFIP’s floodplain management requirements. Flood maps identify the boundaries of the areas that are most at risk of flooding. Property owners whose properties are within special flood hazard areas and who have mortgages from a federally regulated lender are required to purchase flood insurance for the

⁴According to FEMA, many private insurers offer Excess Flood Protection, which provides higher limits of coverage than the NFIP, in the event of catastrophic loss by flooding.

⁵The National Flood Insurance Act of 1968, as amended, is codified at 42 U.S.C. §§ 4001 et seq.

⁶42 U.S.C. § 4001(b).

⁷FEMA defines a community as, any state or area or political subdivision thereof, or any Indian tribe or authorized tribal organization, which has authority to adopt and enforce floodplain management regulations for the areas within its jurisdiction. 44 C.F.R. § 59.1 . In most cases, a community is an incorporated city, town, township, borough, or village, or an unincorporated area of a county or parish.

⁸See 42 U.S.C. 4016.

amount of their outstanding mortgage balance, up to the maximum policy limit of \$250,000 for single-family homes. According to FEMA, Excess Flood Protection coverage above these amounts is available in the private insurance markets. Personal property coverage is available for contents, such as furniture and electronics, for an additional \$100,000. Business owners may purchase up to \$500,000 of coverage for buildings and \$500,000 for contents. The owners of properties with no mortgages or properties with mortgages held by lenders who are not federally regulated are not required to buy flood insurance, even if the properties are in a special flood hazard area. Optional lower-cost coverage is available under the NFIP to protect homes in areas of low to moderate risk.

The NFIP's 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 for policies covering some properties in order to encourage communities to join the program.⁹ As a result, the program does not collect sufficient premium income to build capital to cover long-term future flood losses. Moreover, the premiums collected are often not sufficient to pay for losses even in years without catastrophic flooding. This shortfall is exacerbated by repetitive loss properties that file repeated claims with NFIP.

FEMA's current debt to the Treasury—over \$17.5 billion—is almost entirely for payment of claims from the 2005 hurricanes. Legislation increased FEMA's borrowing authority from a total of \$1.5 billion prior to Hurricane Katrina to \$20.8 billion in March 2006. As we have testified previously, it is unlikely that FEMA will be able to repay a debt of this size and cover future claims, given that the program generates premium income of about \$2 billion a year, which must first cover ongoing loss and expenses.¹⁰

To date, the program has gone through almost two full seasons without a major hurricane, and according to FEMA about \$524 million of premium

⁹GAO, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, [GAO-01-992T](#) (Washington, D.C.: July 2001).

¹⁰GAO, *Federal Emergency Management Agency: Challenges for the National Flood Insurance Program*, [GAO-07-335T](#) (Washington, D.C.: Jan. 25, 2006).

income has been used to pay interest on the debt owed to the Treasury in 2006. FEMA officials also noted that because fiscal year 2007 had been a relatively low flood loss year, the agency should be able to pay its next scheduled interest payment from premium income and would not have to borrow additional funds from Treasury to pay interest on its outstanding debt.¹¹ Attention has been focused on the extent of the federal government's exposure for claims payments in future catastrophic loss years and on ways to improve the program's financial solvency.¹² For example, some in Congress have recommended phasing in actuarial rates for vacation homes and nonresidential properties.¹³

Policy Subsidies Significantly Reduce NFIP's Income from Premiums

About 25 percent of NFIP's over 5.4 million policies have premiums that are substantially less than the true risk premiums. Properties constructed before their communities joined the NFIP and were issued a Flood Insurance Rate Map (or FIRM), which shows the community's flood risk, are eligible for subsidized rates. These policyholders typically pay premiums that represent about 35 to 40 percent of the true risk premium.

In January 2006, FEMA estimated a shortfall in annual premium income because of policy subsidies at \$750 million. In response to concerns about the historical basis for the subsidies and questions about the characteristics of the homes receiving subsidies, we were asked by the Ranking Member of this committee to collect certain demographic information about the portfolio of subsidized properties and property owners. This work will provide information on residential pre-FIRM subsidized properties in selected counties of the country.¹⁴ To the extent that reliable data is available, we plan to capture the variations that exist by type of flooding (e.g., coastal or riverine), fair market values for subsidized and nonsubsidized properties in each location, average income

¹¹According to FEMA officials, the next scheduled payment is October 1, 2007.

¹²See, e.g., S. 3589, § 11, 109th Cong. (2006).

¹³H.R.3121, §121, 110th Cong. (2007).

¹⁴Our key criteria for selecting the case study counties include high number and/or percent of subsidized policies, repetitive loss properties, and number of claims paid; the type of flooding experienced by the community (e.g., coastal, riverine); geographic location (urban/rural, east and west coast, inland/coastal); population demography (racial/ethnic groups and income levels); availability of digitally enhanced-FIRM maps to enable us to overlay on Census maps; and availability of electronic county tax assessment data to enable us to match with NFIP database by property.

levels for each county, claims data for subsidized and nonsubsidized properties in each location, and the mitigation efforts being used. Our work will build upon the work of the Congressional Budget Office on values of properties in the NFIP.¹⁵

As part of this review, we are also examining the extent to which FEMA's nonsubsidized rates are truly actuarially based. We will assess how NFIP sets rates for its nonsubsidized and subsidized premiums, determine the total premiums the NFIP collects, and compare that amount to claims and related costs. Our analysis of FEMA's premiums and claims data should help provide insights into how FEMA sets rates.

We also have work under way that will provide a description of financial and statistical trends, by flood zone, for the past 10 years. Specifically, we have been asked to describe average premium and claim amounts by flood zone, FEMA's estimates of likely losses, and the extent to which losses are attributable to repetitive loss properties or hurricanes. We will also describe the extent to which flood-damaged properties have been purchased through NFIP-funded mitigation programs. However, our ability to report on these issues will depend on the quality of FEMA's claims data. Finally, we are evaluating the adequacy of FEMA's procedures for monitoring selected contracts that support the NFIP.

Repetitive Loss Properties Continue to be a Drain on 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.¹⁶ 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.¹⁷ Although these properties account for only about 1 percent of NFIP-covered properties, they account for between 25 and 30 percent of claims. As of September 2007 over 70,000 repetitive loss properties were insured by the NFIP.

¹⁵CBO, *Value of Properties in the National Flood Insurance Program* (Washington, D.C.: June 2007).

¹⁶Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, section 2(3),(4), (5), 118 Stat. 712, 713 (2004).

¹⁷GAO, *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, [GAO-04-401T](#) (Washington, D.C.: Mar. 25, 2004).

The 2004 Flood Insurance Reform Act authorized a 5-year pilot program to encourage mitigation efforts on severe repetitive loss properties in the NFIP.¹⁸ According to FEMA, as of September 2007 about 8,100 properties insured by the NFIP were categorized as severe repetitive loss properties. Under the pilot, FEMA is required to adjust its rules and rates to ensure that homeowners pay higher premiums if they refuse an offer to mitigate the property. The pilot program was funded in fiscal year 2006, and according to FEMA officials, FEMA has not yet developed the regulations, guidance, and administrative documents necessary for implementation.

Remapping Is Creating A New Generation of Properties That May Not Pay Risk-based Premiums

FEMA is also creating a new generation of properties that may not pay risk-based premiums. Properties that are remapped into higher flood risk areas may be able to keep or “grandfather” the nonsubsidized rates associated with their risk level prior to being remapped into a higher flood risk area. As a result, eligible property owners who have an existing policy or who purchase new flood insurance policies before they are mapped into higher-risk areas will go on paying the same nonsubsidized premium rate.¹⁹ Moreover, these grandfathered rates can be permanent. Although this option is a major selling point of encouraging broader participation in the program, such actions may further erode the actuarial soundness and financial stability of the program.

¹⁸A severe repetitive loss property is defined as a single family property or a multifamily property that is covered under flood insurance by the NFIP and has incurred flood-related damage for which 4 or more separate claims payments have been paid under flood insurance coverage, with the amount of each claim payment exceeding \$5,000 and with cumulative amount of such claims payments exceeding \$20,000; or for which at least 2 separate claims payments have been made with the cumulative amount of such claims exceeding the reported value of the property. 42 U.S.C. § 4102a(b)

¹⁹Generally, post-Flood Insurance Rate Map (Post-FIRM) buildings built in compliance with the floodplain management regulations will continue to have favorable rate treatment even though higher base flood elevations or more restrictive, greater risk zone designations result from Flood Insurance Rate Map revisions. Property owners can also purchase policies after they are remapped by proving that the property was previously mapped.

FEMA Has Expanded Participation in the NFIP, but Ensuring Compliance with Requirements Need Ongoing Attention

From 1968 until the adoption of the Flood Disaster Protection Act of 1973, buying flood insurance was voluntary. However, voluntary participation in the NFIP was low, and many flood victims did not have insurance to repair damages from floods in the early 1970s. In 1973 and again in 1994, Congress enacted laws requiring that some property owners in special flood hazard areas buy NFIP insurance. The owners of properties with no mortgages or properties with mortgages held by lenders that were not federally regulated were not, and still are not, required to buy flood insurance, even if the properties are in special flood hazard areas.

As we have reported in the past, viewpoints differ about whether lenders were complying with the flood insurance purchase requirements, primarily because the officials we spoke with did not use the same types of data to reach their conclusions.²⁰ For example, federal bank regulators and lenders based their belief that lenders were generally complying with the NFIP's purchase requirements on regulators' examinations and reviews that were conducted to monitor and verify lender compliance. In contrast, FEMA officials believed that many lenders frequently were not complying with the requirements, an opinion that they based largely on estimates computed from data on mortgages, flood zones, and insurance policies; limited studies on compliance; and anecdotal evidence indicating that insurance was not always purchased when it was required. At the time of our report in 2002, neither side was able to substantiate these claims with statistically sound data. However, a FEMA-commissioned study of compliance with the mandatory purchase requirement estimated that compliance with purchase requirements, under plausible assumptions, was 75 to 80 percent in special flood hazard areas for single-family homes

²⁰GAO, *Flood Insurance: Extent of Noncompliance with Purchase Requirements Is Unknown*, GAO-02-396 (Washington, D.C.: June 21, 2002).

that had a high probability of having a mortgage.²¹ The analysis conducted did not provide evidence that compliance declined as mortgages aged. At the same time, the study showed that about half of single-family homes in special flood hazard areas had flood insurance.

The 2006 study also found that while one-third of NFIP policies were written outside of special flood hazard areas, the market penetration rate was only about 1 percent. Yet according to FEMA about half of all flood damage occurs outside of high risk areas. FEMA has efforts under way to increase participation by improving the quality of information that is available on the NFIP and on flood risks and by marketing to retain policyholders currently in the program. In October 2003, FEMA contracted for a new integrated mass marketing campaign called “FloodSmart” to educate the public about the risks of flooding and to encourage the purchase of flood insurance. Marketing elements being used include direct mail, national television commercials, print advertising, and Web sites that are designed for communities, consumers, and insurance agents. According to FEMA officials, in the little more than 3 years since the contract began, net policy growth has been almost 24 percent, and policy retention has improved from 88 percent to almost 92 percent. However, the success of the program will be measured by retention rates as policyholders’ memories of the devastation from Hurricane Katrina begin to fade over time.

²¹RAND Corporation, *The National Flood Insurance Program’s Market Penetration Rate: Estimates and Policy Implications*, 2006. This range is based on calculations, using estimates from a stratified random sample of data from 2004. Given the nature of the sample the estimates cannot be extrapolated to communities excluded from NFIP, New York City, and communities in Puerto Rico, Virgin Islands, Guam, and American Samoa. Assumptions made in calculating compliance rate were: (1) The number of policies underwritten by private insurers is 7 percent of the number in Special Flood Hazard Areas (SFHA) by NFIP; (2) 85 percent of mortgages in SFHAs are subject to the mandatory purchase requirement; and (3) The market penetration rates for homes that have mortgages but are not subject to the mandatory purchase requirement is 38 percent (the market penetration rate for homes where the probability of a mortgage is low or uncertain). As with any statistical sample there is error associated with the estimates. Certain regions included estimates with considerable uncertainty, and a larger sample size would be needed to make more definitive conclusions.

FEMA Faces Challenges in Producing Accurate, Updated Flood Maps

Accurate flood maps that identify the areas that are at greatest risk of flooding are the foundation of the NFIP. These maps, which show the extent of flood risk across the country, allow the program to determine high-risk areas for designation both as special hazard zones and as areas that can benefit the most from mitigation. Flood maps must be periodically updated to assess and capture changes in the boundaries of floodplains resulting from community growth, development, erosion, and other factors that affect the boundaries of areas at risk of flooding. The maps are principally used by (1) the communities participating in the NFIP, to adopt and enforce the program's minimum building standards for new construction within the maps' identified floodplains; (2) FEMA, to develop 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. As we reported in 2004, FEMA has embarked on a multiyear effort to update the nation's flood maps at a cost in excess of \$1 billion.²² At that time we noted that NFIP faced major challenges in working with its contractor and state and local partners to produce accurate digital flood maps.

FEMA has taken steps to improve these working relationships by developing a number of guidelines and procedures. According to FEMA, the agency has developed a plan for prioritizing and delivering modernized maps nationwide, including developing risk-based mapping priorities. Moreover, FEMA has recognized that a maintenance program will be needed to keep the maps current and relevant. For example, several strategies are under consideration for maintaining map integrity, including reviewing the flood map inventory every 5 years, as required by law; updating data and maps more regularly, as needed; addressing any unmet flood mapping needs and assessing the quality and quantity of maps; and examining risk management more broadly.²³ However, the effectiveness of these strategies will depend on available funding and FEMA's ongoing commitment to ensuring the integrity of the maps. As of September 2007 FEMA had remapped 34 percent of its maps.²⁴

²²GAO, *Flood Map Modernization: Program Strategy Shows Promise, but Challenges Remain*, GAO-04-417 (Washington, D.C.: Mar. 31, 2004).

²³National Flood Insurance Reform Act of 1994, § 575. 42 U.S.C. §4101.

²⁴According to FEMA, the almost 34 percent includes both new preliminary and effective maps.

FEMA's Monitoring and Oversight Have Identified Specific Problems but Have Not Produced Comprehensive Information on Overall Program Performance

To meet its monitoring and oversight responsibilities, FEMA is required to conduct periodic operational reviews of the private insurance companies that participate in the WYO program. In addition, FEMA's program contractor is required 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 must thoroughly examine 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 procedures has occurred, an incorrect payment has been made, or a file does not 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, among other things, expenses that were paid that were not covered and covered expenses that were not paid. In our December 2006 report, we found that a new claims handling process aided the claims handling following the 2005 hurricane season and resulted in few complaints. As a result, 95 percent of claims were closed by May 2006, a time frame that compared favorably with those of other, smaller recent floods.²⁵ However, we noted that FEMA had not implemented a recommendation from a prior report that it do quality reinspections based on a random sample of all claims.²⁶ We also found that FEMA had not analyzed the overall results of the quality reinspections following the 2005 hurricane season. In response, FEMA has agreed to (1) analyze the overall results of the reinspection reports on the accuracy of claims adjustments for future events, and (2) plan its reinspections based on a random sample of claims.

FEMA faces challenges in providing effective oversight of the insurance companies and thousands of insurance agents and claims adjusters that are primarily responsible for the day-to-day process of selling and servicing flood insurance policies. For example, as we reported in September 2007, 94 WYO insurance companies had written 96 percent of the flood insurance policies for the NFIP as of December 2006, up from the 48 companies that were writing 50 percent of the policies in 1986.²⁷ We also

²⁵[GAO-07-169](#).

²⁶GAO, *Federal Management 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).

²⁷[GAO-07-1078](#).

reported that for fiscal years 2004 through 2006, total operating costs that FEMA paid to the WYO insurance companies ranged from \$619 million to \$1.6 billion, or from more than a third to almost two-thirds of the total premiums paid by policyholders to the NFIP, as a result of unprecedented flood losses caused by the 2005 hurricanes. FEMA regulations require each participating company to arrange and pay for audits by independent certified public accounting firms. However, many WYO insurance companies have not complied with the schedule in recent years. For example, for fiscal years 2005 and 2006, 5 of 94 participating companies had biennial financial statement audits performed. In response to our recommendations, FEMA has agreed to take steps to ensure that it has reasonable estimates of the actual expenses that WYO insurance companies incurred to help determine whether payments for services are appropriate and that required financial audits are performed.

Building on this body of work, we are beginning a follow-up engagement that will analyze the expenses WYO insurance companies incur from selling and servicing NFIP policies and determine whether the total operating costs paid to the companies are equitable relative to those costs. We will also examine how FEMA oversees the WYO program, including reinspecting claims and performing operational reviews. Finally, we will evaluate alternatives for selling and servicing flood insurance policies and processing claims.

We are also completing an engagement that looks at the inherent conflict of interest that exists when a WYO insurance company sells both property-casualty and flood policies to a single homeowner who is subject to a multiple peril event such as a hurricane. We testified before the House Committees on Financial Services and Homeland Security in June 2007 about our preliminary views on the sufficiency of data available to and collected by FEMA to ensure the accuracy of claims payments.²⁸ FEMA has determined that it does not have the authority to collect wind damage claims data from WYO insurance companies, even when the insurer services both the wind and flood policies on the same property. Hence, FEMA generally does not know the extent to which wind may have contributed to total property damages. However, FEMA officials do not believe that the agency needs to know the dollar amount of wind damages

²⁸GAO, *National Flood Insurance Program: Preliminary Views on FEMA's Ability to Ensure Accurate Payments on Hurricane-Damaged Properties*, [GAO-07-991T](#) (Washington, D.C.: June 2007).

paid by a WYO insurance company to verify the accuracy of a flood claim. While they may not need this information for many flood claims, the inherent conflict of interest that exists when a single WYO insurance company is responsible for adjusting both the wind and flood claim on a single property calls for the institution of strong internal controls to ensure the accuracy of FEMA's claims payments. Without internal controls that include access to the entire claim file for certain properties (both wind and flood), FEMA's ability to confirm the accuracy of certain flood claims may be limited. While the DHS Inspector General is currently examining this issue by reviewing both wind and flood claims on selected properties. Its interim report, issued in July 2007, was generally inconclusive.²⁹

Concluding Observations

As our prior work reveals, FEMA faces a number of ongoing challenges in managing the NFIP that, if not addressed, will continue to threaten the program's financial solvency even if the program's current debt is forgiven. As we noted when we placed the NFIP on the high-risk list in 2006, comprehensive reform will likely be needed to stabilize the long-term finances of this program. Our ongoing work is designed to provide FEMA and Congress with useful information to help assess ways to improve the sufficiency of NFIP's financial resources and its current funding mechanism, mitigate expenses from repetitive loss properties, increase compliance with mandatory purchase requirements, and expedite FEMA's flood map modernization efforts.

As you well know, placing the program on more sound financial footing involves a set of highly complex, interrelated issues that are likely to involve many trade-offs. For example, increasing premiums to better reflect risk would put the program on a sounder financial footing but could also 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). As a result, taxpayer exposure for disaster assistance resulting from flooding could increase. As we have said before, meeting the NFIP's current challenges will require sound data and analysis and the cooperation and participation of many stakeholders.

²⁹Department of Homeland Security, Office of Inspector General, *Interim Report: Hurricane Katrina: A Review of Wind Versus Flood Issues*, OIG-07-62. (Washington, D.C.: July 2007).

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 Contact and Staff Acknowledgments

Contact point 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 Orice M. Williams at (202) 512-8678 or williamso@gao.gov. This statement was prepared under the direction of Andy Finkel. Key contributors were Emily Chalmers, Martha Chow, Nima Patel Edwards, Grace Haskins, Lisa Moore, and Roberto Pinero.

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