



AMERICAN ACADEMY *of* ACTUARIES

Committee on Banking, Housing & Urban Affairs

United States Senate

**Hearing on Reauthorization of the
National Flood Insurance Program**

**Statement of Stuart Mathewson, FCAS, MAAA
Chair, Flood Insurance Subcommittee
Extreme Events Committee**

American Academy of Actuaries

June 30, 2011

Chairman Johnson, Ranking Member Shelby, and distinguished members of the Committee, on behalf of the American Academy of Actuaries' Subcommittee on Flood Insurance, I appreciate the opportunity to provide testimony regarding the National Flood Insurance Program (NFIP).

The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

The NFIP is a complex program and is perceived by some/many as having a selective impact within certain areas. Nevertheless, critical factors stemming from constantly changing climate, coastlines, rivers and streams, building construction, land-use, the scientific understanding of hydrology and hydraulics and the technologies used to measure and address flood risk create new opportunities for constructive NFIP reform.

Two issues are of the highest priority with respect to the NFIP. First, we support reauthorizing the program for a period of time of five years or longer to establish some stability in flood insurance coverage. This will help stabilize the market and minimize uncertainty for consumers: policyholders, mortgage holders, taxpayers, the real estate and construction market economies, and insurers and agents. In the recent past, short-term reauthorizations (for fewer than five years) have resulted in dislocations and additional costs to those involved in the process because of the near-term prospect that the program might be permitted to expire. Second, we support efforts to move NFIP insurance rates closer to a financially-adequate level. The underlying principle necessary to guide those efforts is: insurance rates should cover the full cost of the transfers of risk taking place within the program. To accomplish this goal, rates should cover the expected losses and expenses involved in the insurance transaction and should provide a reasonable additional provision for the risk or uncertainty associated with the coverage being provided. This risk provision means that additional premiums should be collected to cover catastrophic events like Hurricane Katrina, which, although infrequent, may happen in any given year.

The current NFIP rate subsidies do not allow the program to generate premiums that are sufficient to cover average annual losses. Furthermore, the NFIP does not collect additional premium, in excess of the premium sufficient to cover average annual losses and expenses, to allow the NFIP to build up catastrophic reserves, so the NFIP must borrow from the United States Treasury when very large loss events do occur.

Before Hurricane Katrina, the NFIP was generally able to repay its debt with subsequent premiums, because the borrowing had been relatively modest. By contrast, the borrowing that was necessary to cover the losses incurred during Hurricane Katrina resulted in a debt many multiples of what it was before. Thus, much of the current income to NFIP goes to paying interest and some part of the principal for that debt. This leaves much less current income to pay losses, increasing the possibility of further borrowing. At the current rate, it will take decades to repay the existing NFIP debt. Consequently, it is important that any NFIP reform legislation address the debt issue to put the program on sound and sustainable financial footing.

In addition to the above priorities, there are several other issues that we believe should be addressed in any reform legislation:

1. If the NFIP could increase and diversify its pool of policyholders, the financial strength of the program would be improved. Thus, we support efforts to increase participation in the NFIP. It is especially important that the percentage of covered properties subject to riverine flooding be increased. Also, properties outside of the 100-year flood plain, but still subject to flooding, have had significant losses but are not well-represented in the NFIP pool. (Ostensibly, properties outside the 100-year flood plain would have lower rates than those within the 100-year flood plain.) In general, the NFIP's premium base would be increased if more of these types of properties were insured. Increased participation in the program would minimize the impact of adverse selection, in which only the owners of the most exposed properties purchase insurance. Minimizing the impact of adverse selection would help to strengthen the program overall.

2. Repetitive loss properties have been shown to be much more at risk than the average property insured by the NFIP. We recommend Congress address this issue and decide whether these properties should be covered at all and, if so, at what price and under what conditions.

3. Continual attention to the updating of flood hazard maps is needed to better identify properties located within severe flood hazard areas. The Risk Mapping, Assessment and Planning (MAP) program provides digital access and dissemination of new maps. The Risk MAP program is intended to allow maps to be updated in a more timely way. More accurate, up-to-date maps allow a better assessment of hazard. The assessment and reassessment of hazard is vital overall to property liability insurance programs. As the hazard changes, so, too, should the rates and premiums. This would allow the NFIP to better differentiate rates among policyholders, resulting in more adequate and equitable premiums.

Finally, the National Flood Insurance Program is critical to protecting home and business owners in the U.S. and should be strengthened and extended for a sufficiently longer reauthorization to allow the program to establish a sound financial footing. Steps should be taken to assure that the true costs are accurately apportioned to all property owners at risk. In addition, the current debt should be addressed, so that the program can use its premium income to pay the future losses that will invariably occur.

Thank you for the opportunity to provide this testimony to the Committee.