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FLOOD INSURANCE REFORM AND MODERNIZATION ACT OF 2007

NOVEMBER 1, 2007.—Ordered to be printed

Mr. DODD, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

R E P O R T

[To accompany S. 2284]

The Committee on Banking, Housing, and Urban Affairs, having had under consideration an original bill (S. 2284) to amend the National Flood Insurance Act of 1968, to restore the financial solvency of the flood insurance fund, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

INTRODUCTION

On October 17, 2007, the Senate Committee on Banking, Housing, and Urban Affairs considered a Committee Print entitled "The Flood Insurance Reform and Modernization Act of 2007," a bill to modernize and bring financial solvency to the National Flood Insurance Program, and for other purposes. The Committee voted unanimously to report the bill to the Senate.

BACKGROUND

Congress established the National Flood Insurance Program (NFIP) in 1968 after finding that floods have "created personal hardships and economic distress which have required unforeseen disaster relief measures and have placed an increasing burden on the Nation's resources." (P.L. 90–448) After flooding events, including flooding in the 1950s, federal disaster assistance was paid out to communities and individuals. In establishing the flood insurance program, Congress wanted to create "a reasonable method of sharing the risk of flood losses through a program of flood insurance which can complement and encourage preventive and protective

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measures." (P.L. 90–448) Through a federal insurance program, the government could collect flood insurance premiums, while tying participation to community efforts to prevent flood losses. Almost 20,000 communities, covering roughly 75 percent of all communities in the United States, now participate in the flood insurance program; these communities must undertake floodplain management activities designed to reduce threats to lives and the potential for damages to property in flood-prone areas.

The flood insurance program is a three-pronged program including insurance, mapping and mitigation. All of these elements are critical to meeting Congressional intent of linking insurance with protective measures. Communities that choose to participate in the program are required to undertake mitigation efforts to limit flood related damage as well as to implement stringent building codes for all new development. All buildings in the Special Flood Hazard Areas, or the 100-year flood plain, are required to meet these stringent building code requirements and are required to carry flood insurance.

Properties that were built prior to the inception of the program and the completion of flood insurance rate maps (pre-FIRM properties) pay subsidized rates as intended by Congress. Congress believed that it was inequitable to require all property owners to pay actuarial rates, given that structures were built prior to rate maps and the flood program, resulting in premiums on these properties that would be prohibitively expensive. In 1978, 70 percent of properties in the flood program were subsidized, compared to under a quarter of homes in the program today. These properties do not pay actuarial rates, leaving the flood program with less funds than needed to pay for losses in higher than average loss years. While Congress initially believed that pre-FIRM properties would be destroyed, rebuilt, or mitigated, the phaseout of pre-FIRM properties has been slow. Modern construction techniques have extended the useful life of these buildings. To address the most at-risk properties, in 2004 Congress established a severe repetitive loss pilot program to mitigate those properties that experienced multiple flood losses. These properties are a drain on the National Flood Insurance Program, and Congress intends for FEMA to take actions to assist in relocating, rebuilding, elevating, or undertaking other mitigation efforts with respect to these pre-FIRM properties.

Explicit rate subsidies are not the only cause of financial difficulties in the flood program. Flood maps, a critical component of the program, are out of date and in many cases, inaccurate. A large majority of flood maps are over a decade old, leaving communities and their residents without an accurate assessment of flood risks. According to FEMA, "because flood hazards are dynamic and usually increase over time as development occurs, old maps tend to understate actual existing flood hazards. Additionally, most of the maps were produced using now antiquated manual cartographic techniques." (NFIP—Program Description, August 1, 2002) FEMA has identified lack of funding as the primary reason that flood maps are out of date.

In addition, participation in the program is not as robust as Congress anticipated. Since 1973, participation in NFIP is required for properties in the 100-year flood plain with federally regulated mortgages. Such mandatory purchase is enforced through federal

banking regulations. Many property owners without federally backed mortgages, and those with no outstanding mortgage, have chosen not to participate in the program. In fact, according to recent studies conducted by the American Institutes for Research, less than 50 percent of single-family homes in special flood hazard areas, and only 75–80 percent of property owners required to purchase flood insurance, actually do so. Notwithstanding the decision of many owners not to participate, all of the structures within the 100-year floodplain are exposed to heightened risk.

While only 1 percent of homes outside mandatory purchase areas have flood coverage through NFIP, 25 percent of flood claims are outside of the 100-year floodplain. This indicates that areas of residual risk, outside the 100-year floodplain, are also at risk of flooding. Structures in "residual risk areas," those protected by manmade structures such as dams or levees, are not required to purchase flood insurance. While the risk of flooding for these properties remains low, a flooding event caused by a breached dam or levee, in a residual risk area, is likely to be widespread and cause significant flood damage.

In 1983, in an effort to increase effectiveness and participation in the program, NFIP formed a public-private partnership with private insurance companies. Under this partnership, private insurance companies, known as Write Your Own (WYO) companies, handle the sale and administration of flood insurance policies. Over 90 percent of flood policies are sold through WYO companies, though the federal government underwrites the policies. 88 private insurance companies participate in the WYO program, and they are paid an administrative fee of over 30 percent of all premiums collected, as well as 3.3 percent of any claims paid, and additional fees for adjusting claims, and writing additional policies. The formula for devising the fees paid to WYO companies is based on the administrative costs in other insurance lines, not on actual costs of administering this program.

The NFIP has grown significantly over its history from 1 million policyholders and $50 billion of risk exposure to over 5.4 million policyholders with in excess of $1 trillion of risk exposure. While the program has been largely self-sustaining, the catastrophic nature of the 2005 hurricane season, coupled with the flood losses of 2004, showed weaknesses in the program and left FEMA with almost $20 billion in debt to the U.S. Treasury. In the years between the program's inception and 2005, taxpayers paid out $1 billion for flood claims, with the large majority of claims being paid through premium income. Claims payments resulting from the 2005 hurricanes exceed the cumulative claims payments made to policyholders since the program began. Due to the structure and the current financial situation of NFIP, the program is not in a position to meet the claims of policyholders, nor is it in a position to pay back the debt incurred from the 2005 claims.

PURPOSE OF THE LEGISLATION

This legislation makes several key reforms to ensure that the program can continue to operate, is self-sustaining, and adequately identifies areas at risk of flood loss.

FEMA, as well as the Congressional Budget Office and the General Accounting Office, has indicated that it will be unable to repay

the debt currently owed to the U.S. Treasury. Interest alone on this debt is approximately $900 million annually, almost 40 percent of annual premium income. To ensure the continuation of NFIP as well as the long-term financial solvency of the program, this bill forgives the almost $20 billion in debt, and makes a number of changes designed to increase the ability of the program to pay claims in the future.

Under this bill, additional property owners will be required to purchase flood insurance, and those in the 500-year flood plain will be told of their flood risks, increasing the likelihood that they will voluntarily purchase flood coverage. This legislation will require flood coverage for property owners in residual risk areas, those behind levees and downstream from dams, as well as property owners in the 100-year flood plain or residual risk areas with mortgages through state-regulated lending institutions. In addition, the bill requires that flood insurance premiums be escrowed to ensure continuity of insurance coverage. While most property owners will not face significant increases in charged premiums as a result of this bill, certain pre-FIRM structures will, over time, be required to pay actuarial rates; those that are non primary residences, including vacation homes and businesses, severe repetitive loss properties and properties substantially damaged or improved.

This legislation will require FEMA to review rates and use actuarial principles in setting rates in NFIP. FEMA will also be required to review and conduct rulemaking on insurance company reimbursement so that reimbursements and actual administrative expenses are aligned. FEMA will also be required to build up a reserve fund, over time, equal to 1 percent of all insurance in force so that it can pay for flood claims in high loss years. These changes are designed to protect the taxpayer from paying for flood insurance claims in all but the most catastrophic loss years.

The legislation also establishes a map modernization program so that maps are updated, accurate and readily available. The Technical Mapping Advisory Council is re-established to ensure that FEMA adopts meaningful standards for mapping that are consistent and based on the most accurate data and information.

In addition, the bill reiterates FEMA's responsibilities under the Bunning-Bereuter-Blumenauer flood reform bill of 2004 to establish minimum training standards for insurance agents who sell flood policies, so that prospective policyholders are given accurate and consistent information and are sold the correct coverage. The severe repetitive loss mitigation pilot program established in 2004 is extended through 2013 so that, when implemented, there are a full five years of mitigation activities for the most at-risk properties. In addition to the pilot program, the Committee expects FEMA to take all actions at its disposal to mitigate flood risks, including its authority under Section 1361 of the National Flood Insurance Act of 1968 to encourage local and state measures to guide development and assist in reducing flood damage. Criteria used to determine community participation in the program should be reviewed and should ensure that the original intent of Congress, to mitigate flood risk, is met. These criteria can include zoning, building codes and other local land use provisions that can assist in meeting this important goal.

HEARINGS

The Committee heard testimony in the 110th Congress on October 2, 2007, regarding proposals to reform the National Flood Insurance Program. The witnesses were: Mr. David Maurstad, Assistant Administrator for Mitigation and Federal Insurance Administrator, Federal Emergency Management Agency; Ms. Orice Williams, Director of Financial Markets and Community Development, Government Accountability Office; Mr. Chad Berginnis, CFM, State Hazard Mitigation Officer, Ohio Emergency Management Agency, on behalf of the Association of State Floodplain Managers, Inc.; Dr. Gerald E. Galloway, Professor of Engineering, University of Maryland; Mr. J. Robert Hunter, Director of Insurance, Consumer Federation of America; Mr. Vince Malta, National Association of Realtors; Mr. Mark Davey, President and Chief Executive Officer, Fidelity National Insurance Company; and Mr. Don Griffin, Vice President, Personal Lines, Property Casualty Insurers Association of America.

In the 109th Congress, the Committee held hearings regarding proposals to reform the national flood insurance program. On February 2, 2006, the witnesses testifying were: Mr. David Conrad, Senior Water Resources Specialist, National Wildlife Federation; Ms. Regina Lowrie, Chair, Mortgage Bankers Association; Mr. J. Robert Hunter, Director of Insurance, Consumer Federation of America; Mr. David Pressly, President, National Association of Homebuilders; Mr. Paul Gessing, Director of Government Affairs, National Taxpayers Union; Mr. David John, Research Fellow, The Heritage Foundation; and Ms. Pam Pogue, Chair, Association of State Floodplain Managers. On January 25, 2006 the witnesses were: The Honorable David Walker, Comptroller General, United States Government Accountability Office; Mr. David Maurstad, Acting Director, Mitigation Division, Federal Emergency Management Agency; and Mr. Donald Marron, Acting Director, Congressional Budget Office.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This section contains the short title of the bill, "Flood Insurance Reform and Modernization Act of 2007."

Section 2. Findings

This section contains the Committee's findings that the flood insurance program is in debt and that the program must be strengthened to ensure it can pay future claims.

Section 3. Definitions

This section defines the 100- and 500-year floodplain, as well as "Write Your Own."

Section 4. Extension of National Flood Insurance Program

This section reauthorizes the National Flood Insurance Program through 2013.

Section 5. Availability of insurance for multifamily properties

This section allows multifamily residential buildings, those with 4 or more units, to purchase flood insurance up to the commercial coverage limits, currently $500,000 for the structure. There is currently some confusion about what level of coverage is available for these multifamily properties.

Section 6. Reform of premium rate structure

Currently, 25 percent of properties in the flood insurance program pay subsidized rates because they were built prior to flood rate maps (pre-FIRM). To strengthen the financial situation of NFIP, this section requires the following pre-FIRM properties to pay actuarial rates (rates that reflect the true risk of flooding) phased in over 4 years: non-primary residences, severe repetitive loss properties, any properties where flood losses have exceeded the property value, and any business property. In addition, FEMA will be permitted to increase premiums by 15% per year, up from the current 10% cap.

This section requires that any new flood insurance policy for a property not covered by a flood insurance policy as of the date of passage must be insured at actuarial rates.

Section 7. Mandatory coverage areas

This section requires the Director to issue an amended regulation defining special flood hazard areas, those where flood insurance is mandated, to include residual risk areas, those protected from flooding by man-made structures such as levees or dams. Once all essential residual risk areas are mapped, properties in these areas will be required to purchase flood insurance.

Section 8. Premium adjustment

This section prohibits FEMA's current practice of allowing properties that are remapped into the 100-year floodplain to indefinitely pay rates that reflect their old risk level. Properties mapped into the 100-year flood plain must pay rates reflecting their new risk designation. Properties covered by flood insurance at the time of remapping will have the new rates phased in over 2 years.

Section 9. State chartered financial institutions

This section requires that by December 31, 2008, as a condition of state participation in the National Flood Insurance Program, lending institutions chartered by the states and not insured by the Federal Deposit Insurance Corporation shall be subject to regulations by that State that are consistent with the requirements for federal depository institutions with regard to maintaining flood insurance on mortgaged properties in special flood hazard areas. This will, in effect, require mandatory purchase of flood insurance for those properties in the 100-year floodplain with mortgages through state-regulated lending institutions. The Committee believes that all properties at risk, regardless of type of mortgage or lender, should carry flood insurance coverage.

Section 10. Enforcement

This section increases the cap on civil monetary penalties for lenders that fail to ensure that properties required to have flood

coverage purchase such coverage from $350 to $2000 per violation. This section also eliminates the $100,000 annual cap on fines that can be levied against a lender. The Committee urges FEMA to consistently review mandatory purchase compliance.

Section 11. Escrow of flood insurance

This section requires that lending institutions place flood insurance payments into an escrow account on behalf of the borrower. This section shall apply to any mortgage outstanding or entered into on or after the expiration of the 2-year period beginning on the date of the enactment of this Act.

Section 12. Borrowing authority debt forgiveness

This section completely eliminates any obligations owed to the United States Treasury by the National Flood Insurance Program for the 2005 hurricane season. This section also decreases the borrowing authority for the program from $20.775 billion to $1.5 billion, the borrowing authority prior to the 2005 storm season. The Committee believes this is necessary for the future of the flood program; without debt forgiveness, FEMA will have to substantially increase premiums on all policyholders.

Section 13. Minimum deductibles for claims under the National Flood Insurance Program

This section increases minimum deductibles as follows: minimum pre-FIRM property deductibles will be increased from $1,000 to (a) $1,500 if the property is insured for $100,000 or less or (b) $2,000 if the property has over $100,000 in coverage. Minimum post-FIRM property deductibles will increase from $500 to (a) $750 for those with $100,000 of coverage or less, or (b) $1,000 if the flood insurance policy covers greater than $100,000.

Section 14. Considerations in determining chargeable premium rates

NFIP currently prices premiums to cover an average loss year. This section requires NFIP to use actuarial principles in determining rates, and to consider catastrophic loss years in the calculation of average losses.

Section 15. Reserve fund

To help cover losses in higher-than-average loss years, this section creates a reserve fund of 1 percent of all risk exposure in force within the program. FEMA will be required to put 7.5 percent of the target reserve fund away each year until the reserve fund meets its target. This section also gives discretion to the Director to report to Congress if hitting the reserve target ration for any given fiscal year would have serious negative implications for the overall program. In order to meet reserve targets, FEMA may not increase premiums more than otherwise allowable.

Section 16. Repayment plan for borrowing authority

This section requires detailed reporting and repayment plans be submitted to the Treasury and Congress whenever NFIP borrows funds to pay for losses in the National Flood Insurance Program.

Section 17. Payment of condominium claims

This section clarifies that condominium owners with flood insurance policies should receive claims payments regardless of the adequacy of flood insurance coverage of the condominium association and other condominium owners.

Section 18. Technical Mapping Advisory Council

This section re-establishes the Technical Mapping Advisory Council, similar to the one established in 1994, to ensure that NFIP adopts meaningful standards for updating and maintaining maps. The Advisory Council will be comprised of government officials and others with expertise in mapping, and will make recommendations to FEMA on how to improve the accuracy of maps and on standards that should be adopted for flood rate maps, data, map maintenance efforts and funding needs and strategy. FEMA will be required to report annually to Congress on recommendations made by the Technical Mapping Advisory Council and actions taken by FEMA to address such recommendations.

Section 19. National Flood Mapping Program

This section requires FEMA to establish an ongoing mapping program to review, update and maintain flood insurance rate maps, including all areas within the 100-year and 500-year floodplains and areas of residual risk, including those protected by levees and dams. Requires that the most accurate data be used in mapping and maintenance, and requires that each map include certain elements to ensure consistency and accuracy. This section authorizes $400 million annually for mapping.

Section 20. Removal of limitation on state contributions for updating flood maps

This section lifts the current prohibition barring states from contributing greater than 50 percent of the cost of map modernization, thus allowing states to invest additional funds in mapping.

Section 21. Coordination

This section requires the various federal departments (e.g. NOAA, FEMA, USGS) to work together to coordinate mapping and risk determination budgeting, and requires OMB, FEMA and others to submit a joint report to Congress within 30 days of the budget submission on the crosscutting budget issues with respect to mapping.

Section 22. Interagency coordination study

This section requires FEMA to contract with the National Academy of Public Administration to conduct a study on how FEMA can improve interagency coordination on flood mapping and funding, and how FEMA can establish joint funding mechanisms with federal, state, and local agencies to share the collection and use of data for mapping.

Section 23. Non mandatory participation

This section states that while it is not mandatory to purchase flood insurance in the 500-year floodplain, due to the risk of flooding, it requires that communities be given notice when they are

mapped into a 500-year floodplain, and requires lenders to give notice to purchasers of property in the 500-year floodplain.

Section 24. Notice of flood insurance availability under RESPA

This section amends 5(b) of the Real Estate Settlement Procedures Act (RESPA) by requiring the Secretary of Housing and Urban Development to include in the booklet distributed an explanation of, and information on, the availability of flood insurance.

Section 25. Testing of new flood-proofing technologies

This section permits structures to be built to test flood-proofing methods so long as the structures are taken down after testing. There is some concern about the safety of flood-proofing, and this Committee believes that FEMA should consider the safety of any planned testing.

Section 26. Participation in state disaster claims mitigation

Requires FEMA, at the request of a State Insurance Commissioner, to take part in state-sponsored, non-binding mediation to resolve insurance claims disputes where there are multiple insurance claims on the same property. This section also maintains federal jurisdiction over NFIP.

Section 27. Reiteration of FEMA responsibilities under the 2004 Reform Act

This section reiterates the responsibilities of FEMA under the 2004 Act to establish minimum training requirements, and requires that FEMA report to Congress within 3 months on the status of all reforms. The Committee is disappointed with FEMA's progress on these critical reforms, and expects FEMA to quickly move to implement any outstanding measures.

Section 28. Additional authority of FEMA to collect information on claims payments

To ensure that FEMA can determine the accuracy of flood claims payments, this section requires FEMA to collect from insurance companies that sell flood insurance policies (Write Your Own companies) information on total claims made on a property in addition to flood, including wind and other damages, if the insurance company also underwrites the insurance for the other damages.

Section 29. Reimbursement of Write Your Own companies

This section requires that FEMA collect accurate and adequate information on WYO company expenses. Under this section, FEMA is required to conduct rulemaking within 180 days formulating a data collection methodology to gather expense information from insurance companies in a consistent manner. Within 60 days of a final rule on expense data collection, all Write Your Own companies will be required to submit 5 years of data based on that methodology. Using that data, FEMA will be required to conduct rulemaking on reimbursement rates, to ensure that Write Your Own companies are being reimbursed based on actual expenses, including standard business costs and operating expenses. After the rulemakings, GAO is required to report to Congress on the efficacy of the rules.

Section 30. Studies and reports

This section requires FEMA to submit an annual report to Congress on NFIP's activities and financial health, including the amount paid in premiums, losses, expenses, number of policies, insurance in force, estimate of average loss year and a description and amount of claims paid. This section also requires GAO to conduct a study of pre-FIRM structures to determine what types of properties are pre-FIRM, who owns the properties, locations, property values, and other information.

In addition, this section requires GAO, in consultation with the Department of Homeland Security Inspectors General office, to review the three largest contractors used by FEMA in operating and managing the flood insurance program. It is the Committee's understanding that much of the administration of this program is done by contractors. It is in the government's best interest to ensure that this program is operating in a cost-effective way and that there are no conflicts of interest in using outside contractors to manage this program.

Section 31. Extension of pilot program for mitigation of severe repetitive loss properties

This section extends the pilot program established in 2004 to mitigate severe repetitive loss properties through 2013. FEMA will be required to issue a rule implementing the pilot program within 90 days, and report to Congress on status and implementation of the pilot program within 6 months. The Committee is concerned with the status of this pilot program, and the length of time it has taken FEMA to implement this important program which will help protect people and properties in harm's way, as well as mitigate properties which have been a financial drain on the program.

Section 32. Flood insurance advocate

This section establishes an Office of the Flood Insurance Advocate to assist policyholders with any problems they have with the NFIP and claims, to propose administrative changes to the Director that will help policyholders, and to make recommendations for legislative and regulatory changes needed in the program. The Flood Advocate will report to the Director of NFIP but will submit annual reports directly to Congress without review or approval at FEMA or in the Administration to ensure independence. The Flood Advocate will have the power to open regional offices, as well as temporary local offices to serve policyholders after a flooding event.

COST OF LEGISLATION

OCTOBER 31, 2007.

Hon. CHRISTOPHER J. DODD,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Flood Insurance Reform and Modernization Act of 2007.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Daniel Hoople (for fed-

eral costs), Melissa Merrell (for the state and local impact), and Paige Piper/Bach (for the private-sector impact).

Sincerely,

PETER R. ORSZAG.

Enclosure.

Flood Insurance Reform and Modernization Act of 2007

Summary: The Flood Insurance Reform and Modernization Act of 2007 would modify the National Flood Insurance Program (NFIP) to increase the amount of premiums collected and reduce the cost of expected claims. The program's outstanding debt to the Treasury of $17.5 billion also would be forgiven. CBO expects that enacting this legislation would improve the financial status of the NFIP and significantly increase the likelihood that the program could continue to offer insurance coverage and pay claims in a timely fashion. CBO expects that without a change in law, the NFIP will be unable to pay all flood insurance claims promptly, and faced with a nonfunctional program, policyholders may abandon it. In such cases, the federal government may be called upon to provide additional relief in the aftermath of a disaster for properties that would have otherwise been insured. CBO cannot predict when this might occur, but today, the program faces a future with inadequate resources to pay its obligations.

The bill would direct the Federal Emergency Management Agency (FEMA) to increase premium rates by 25 percent per year on certain policies that pay less than the expected cost under current law. FEMA would be authorized to impose average annual rate increases of up to 15 percent on all other categories of policyholders. CBO estimates that premium increases at this maximum level would be necessary to establish the reserve fund that would be created under the bill to pay insurance claims whenever necessary. Finally, the bill would require policyholders to carry a larger deductible and would end the current practice of offering new policies to some property owners at less than their expected cost. These changes would increase the cost to policyholders and reduce the net cost of the program to the federal government.

CBO estimates that the proposed changes to the NFIP and the elimination of its Treasury debt would increase premium revenue over the next 10 years by nearly $19 billion and would reduce NFIP outlays by about $10.6 billion relative to current law. CBO expects this legislation would allow the program to avoid developing a growing backlog of unpaid claims, which we estimate could reach a value of $21 billion by 2017. At the same time, because the bill would forgive the NFIP's debt to the Treasury, CBO estimates that the Treasury would forgo interest payments from the NFIP of about $9.7 billion over the 2008–2017 period. The net impact of the bill—including its effect on the NFIP and on the Treasury's interest collections—would be an increase in direct spending of about $1.2 billion over the 2008–2017 period.

As the value of flood insurance coverage in force continues to grow, the expected cost of claims that the NFIP will face in the next decade also will increase. In most years, they will probably total between $1 billion and $5 billion—similar to the losses the insurance program experienced in the years before Hurricane Katrina—but there could be another catastrophic flood in the next

decade with much larger losses. CBO's estimate assumes that annual flood insurance claims during this period, under current law, will be equal to the amounts anticipated by the program's actuaries on an expected annualized basis (which includes some probability that a catastrophic event would occur). This estimate also assumes that substantial numbers of policyholders would drop flood insurance coverage or find alternatives to the NFIP as their premiums rise steadily over the period.

The bill would authorize the appropriation of $2.4 billion over the 2008–2013 period for FEMA's flood mapping program. In addition, it would authorize the appropriation of $190 million over the 2008–2013 period to extend the pilot program to mitigate severe repetitive losses through 2013 and establish the Office of the Flood Insurance Advocate. Finally, the bill would require FEMA to participate in state-sponsored mediation programs and would direct the Government Accountability Office (GAO) to conduct multiple studies on the NFIP. Assuming appropriation of the necessary amounts, CBO estimates that implementing those provisions would cost about $1.6 billion over the 2008–2012 period and an additional $1 billion after 2012.

The bill contains two intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) because it would direct state regulatory agencies to require, and state lenders to provide, information on flood risk to more mortgage borrowers. CBO estimates that the cost for state governments to comply with those mandates would be small and well below the annual threshold established in UMRA ($66 million in 2007, adjusted annually for inflation).

The bill also would impose private-sector mandates, as defined in UMRA, on certain mortgage lenders. Based on information from industry sources and FEMA, CBO expects the direct costs to comply with those mandates would fall below the annual threshold for private-sector mandates established in UMRA ($131 million in 2007, adjusted annually for inflation).

Estimated cost to the Federal Government: The estimated budgetary impact of the legislation is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

	By fiscal year, in millions of dollars—											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008–2012	2008–2017
CHANGES IN DIRECT SPENDING [1]												
Changes to the NFIP:												
Estimated Budget Authority	725	600	175	0	0	0	0	0	0	0	1,500	1,500
Estimated Outlays	725	600	175	0	−225	−800	−1,275	−1,850	−2,525	−3,325	1,275	−8,500
Forgone Treasury Interest Receipts:												
Estimated Budget Authority	775	925	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	4,700	9,700
Estimated Outlays	775	925	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	4,700	9,700
Total Changes:												
Estimated Budget Authority	1,500	1,525	1,175	1,000	1,000	1,000	1,000	1,000	1,000	1,000	6,200	11,200
Estimated Outlays	1,500	1,525	1,175	1,000	775	200	−275	−850	−1,525	−2,325	5,975	1,200
CHANGES IN SPENDING SUBJECT TO APPROPRIATION												
Flood Mapping:												
Authorization Level	400	400	400	400	400	400	0	0	0	0	2,000	2,400
Estimated Outlays	100	260	340	400	400	400	300	140	60	0	1,500	2,400
Severe Repetitive Loss Mitigation Pilot Program:												
Authorization Level	0	0	40	40	40	40	0	0	0	0	120	160
Estimated Outlays	0	0	8	24	40	40	32	16	0	0	72	160
Office of Flood Insurance Advocate:												
Authorization Level	5	5	5	5	5	5	0	0	0	0	25	30
Estimated Outlays	3	5	5	5	5	5	2	0	0	0	23	30
GAO Studies:												
Estimated Authorization Level	1	0	0	0	0	0	0	0	0	0	1	1
Estimated Outlays	1	0	0	0	0	0	0	0	0	0	1	1
Total Changes:												
Estimated Authorization Level	406	405	445	445	445	445	0	0	0	0	2,146	2,591
Estimated Outlays	104	265	353	429	445	445	334	156	60	0	1,596	2,591

[1] In addition, CBO estimates that revenues from civil penalties assessed on lenders would increase by about $1 million a year over the 2008–2017 period.

Basis of estimate: For this estimate, CBO assumes that the bill will be enacted by the end of calendar year 2007 and that the authorized amounts will be appropriated for each fiscal year.

To estimate program expenses over the next 10 years, CBO assumes that reimbursement agreements to private insurance companies that sell and service flood insurance policies on the behalf of the federal government will remain unchanged. In addition, we assume that claims over the next 10 years, under current law, will equal amounts anticipated by the program on an actuarial basis (which includes some proportionate risk of catastrophic events) and that the premium currently assessed by FEMA on unsubsidized policies is sufficient to cover the full risk of the insurance.

Direct spending and revenues

Over the 2008–2017 period, CBO estimates that enacting the legislation would reduce net outlays for the flood insurance program by about $8.5 billion and would increase the Treasury's outlays for interest by about $9.7 billion—an estimated net increase in direct spending of $1.2 billion over the ten year period.

Changes to the NFIP. The Flood Insurance Reform and Modernization Act of 2007 contains several provisions that together would govern the magnitude of future rate increases for flood insurance and reduce the amount of expected claims. Those provisions would:

- Require the NFIP to establish a reserve fund;
- Increase the ceiling on average annual rate increases that can be imposed on policyholders from 10 percent a year to 15 percent a year;
- Forgive the program's outstanding debt to the Treasury;
- Phase out subsidized premiums for some policyholders;
- Require policyholders to carry a larger deductible; and
- Prohibit FEMA from subsidizing new or previously unsubsidized policies.

CBO estimates that those changes would reduce net outlays of the NFIP because premium increases would be greater than those that would occur under current law and because no interest would have to be paid to the Treasury on the program's current debt. That decline would be partially offset by higher claims payments because, under the bill, the NFIP would have sufficient funds to pay expected claims; under current law, CBO expects it would not.

Establish a Reserve Fund and Increase the Limit on Annual Rate Increases. FEMA would be required to establish a reserve fund equal to at least 1 percent of the value of flood insurance coverage in force during the previous year. As of August 2007, FEMA reported that flood insurance coverage in force totaled about $1.1 trillion. During the five-year period prior to the hurricane seasons of 2004 and 2005, total coverage had been increasing by about 7 percent per year. If such a rate were to continue into the future, the amount of flood insurance coverage would reach about $2.1 trillion by 2017. CBO estimates, however, that coverage in force would reach about $1.8 trillion under the bill, because some policyholders would drop coverage as a result of the premium increases estimated to occur under the bill. FEMA would gradually accumulate reserves by depositing an amount equal to 7.5 percent of the required reserve in each year until the fund is fully capitalized.

The bill also would increase the maximum amount that FEMA could increase average premium rates within each risk category from 10 percent to 15 percent. CBO expects that FEMA would need to increase most rates by the maximum allowable percentage under the bill in order to pay claims and accumulate the required reserves, even if those rates exceed the amount FEMA estimates would cover the full cost of providing flood insurance. Even so, assuming that claims over the next several years occur at the level estimated by actuarial studies, a significant portion of the increased premium collections would be needed to pay flood claims and would not be available to accumulate in a reserve. Therefore, CBO estimates that it would be unlikely that FEMA would be able to collect enough premiums to meet the reserve fund target in the first few years after enactment. However, as successive rate increases are implemented, we estimate that the reserve fund would begin to accumulate reserves totaling about $8.5 billion by 2017, which is over half the amount that would be required to be deposited under the bill by that time. (If losses due to floods are less than the actuarial average over the period, the balance would be greater. If losses exceed the average—for example, because of a catastrophic event—the balance would be smaller. Based on FEMA's actuarial review of the NFIP, CBO estimates that the expected annualized loss would be about $2.4 billion for policies in force in 2008.)

For this estimate, CBO assumes that FEMA could begin to implement premium increases to establish the reserve fund in May 2009. In the past, FEMA has typically proposed rate increases in November that would be effective in May of the following year. It takes a year before any rate increase is fully implemented because individual flood insurance policies are renewed throughout the year.

To estimate the amounts that could be collected and deposited into the reserve fund, CBO reduced the projected value of flood insurance in force to reflect the likelihood that some policyholders would drop NFIP coverage after successive years of 15 percent annual rate increases which could quadruple their insurance premiums if sustained for 10 years. Policyholders living in lower-risk areas would be especially likely to seek out and find alternative insurance products if their cost to participate in the NFIP far exceeds their actuarial risk. In addition, some policyholders might retain their policies, but choose to reduce the amount of coverage.

Increase Rates for Pre-FIRM Properties. The bill also would authorize the NFIP to implement larger average rate increases on certain properties that were built before flood insurance rate maps (FIRMs) were completed or before 1975, whichever is later. Those properties are collectively known as pre-FIRM properties. The bill would authorize annual average rate increases of up to 25 percent for certain pre-FIRM properties, including:

- Nonresidential structures;
- Nonprimary residences (such as vacation homes);
- Properties that have been flooded four or more times with total claims payments exceeding $20,000; or properties with two or more claims exceeding the fair market value of the property (also know as severe repetitive loss properties);

- Properties that sustain damage exceeding 50 percent of the fair market value of the property after enactment of the bill; and
- Properties that undergo improvements or renovations exceeding 30 percent of the fair market value of the property.

Under current law, the NFIP charges many pre-FIRM properties a premium that is less than the actuarial cost of the insurance. On average, FEMA estimates that those policies are discounted between 60 and 65 percent. Under the bill, FEMA would increase rates on those specified types of pre-FIRM properties by 25 percent per year until the actuarial rate is achieved. At this rate, CBO expects that most of those pre-FIRM properties would start paying actuarial premiums within the next 10 years.

Based on information from FEMA, CBO estimates that about 475,000 pre-FIRM properties would be affected by the bill. The average premium for those properties is about $800 a year. CBO expects that owners of some of those properties would either drop flood insurance coverage or reduce their level of coverage in response to an increase in premium charges.

Raise Deductible for Pre-FIRM Properties. Section 13 would increase the annual deductible from $1,000 to $1,500, for pre-FIRM properties with coverage of less than $100,000 and from $1,000 to $2,000 for pre-FIRM properties with coverage of more than $100,000. The bill also would increase the deductible for post-FIRM properties from $500 to $750 for coverage less than $100,000 and from $500 to $1,000 for coverage greater than $100,000. Based on information from FEMA, CBO estimates that claims payments for all properties would decrease by an average of 5 percent if this higher deductible were implemented.

Forgone Treasury Interest Payments. Section 12 would relieve the NFIP of its obligation to repay funds borrowed to pay claims from the 2005 hurricane season. As of September 2007, the program had an outstanding debt of $17.5 billion. Current law requires FEMA to repay any borrowed funds (with interest) as it collects premiums. In the absence of this legislation, FEMA would need to use a portion of its premium income to repay debt-service costs to the Treasury. Under this bill, such payments would not be necessary, and income that the NFIP would otherwise use to service this debt would instead be used to pay policyholders' claims and to accumulate reserves.

Interest payments from the NFIP to the Treasury are intragovernmental transactions. Eliminating those payments would increase the Treasury Department's net outlays by an estimated $1 billion per year because it would be receiving less interest income. While the forgiveness of the debt would reduce FEMA's outlays for interest payments, CBO expects that the program would use such funds to pay claims that would have otherwise gone unpaid under current law. As such, CBO estimates that forgiving FEMA's obligations to the Treasury would increase net outlays of the federal government by $9.7 billion over the 2008–2017 period.

Civil Penalties. Section 10 would increase the civil penalty from $350 to $2,000 for lenders that do not enforce the mandatory flood insurance purchasing requirement. CBO estimates that the increased revenue from the civil penalties established under this bill would amount to about $1 million a year.

Other NFIP Modifications. The bill would make certain changes to the NFIP that might increase the number of policies in the program and result in the program collecting more premium income than it would under current law. CBO does not have sufficient information to estimate the number of policies that could be added to the program from enacting those sections. However, because CBO assumes that the additional policies generated by those provisions would be priced initially at full-risk rates, any additional premiums collected would be at least sufficient to pay out claims on an expected-value basis.

Mandatory Coverage Areas. Section 7 would require that homes located behind levees, dams, and other man-made structures become part of special flood hazard areas. The bill would require property owners to purchase flood insurance once the NFIP updates its flood maps to include those new areas.

Expansion of Mandatory Coverage Requirement to State Chartered Lenders. Section 9 would require that the NFIP refrain from selling flood insurance policies in states that do not require state-chartered lenders to require that certain loans be covered by flood insurance at certain levels. Under current law, such a requirement already exists for lenders insured by the Federal Deposit Insurance Corporation.

Nonmandatory Participation for the 500-year Floodplain. Section 23 would require the NFIP and regulated lending institutions to notify communities if they are entirely or partially located within the 500-year floodplain (that is, an area with at least a 0.2 percent chance of being inundated with water in any year). Owners of properties within the 500-year floodplain (but outside of the 100-year floodplain) would not be subject to mandatory purchase requirements but might voluntarily purchase flood insurance upon receiving notification of potential risk.

Spending subject to appropriation

The bill also would authorize additional discretionary spending. Assuming appropriation of the specified amounts, CBO estimates that such spending would total about $1.6 billion over the 2008–2012 period.

Flood Mapping Program. Section 19 would authorize the appropriation of $400 million for each of fiscal years 2008 through 2013 to update and maintain flood maps. In 2007, the Congress provided $199 million for this activity (see Public Law 109–295). Under the bill, maps also would be updated to include the 500-year floodplain and areas that would be flooded if a dam or levee failed. In addition, the bill would reestablish the Technical Mapping Advisory Council to assist with managing flood mapping activities. Based on historical spending rates for this program, CBO estimates that implementing this provision would cost $1.5 billion over the 2008–2012 period and an additional $900 million thereafter, subject to appropriation of the specified amounts.

Severe Repetitive Loss Mitigation Pilot Program. Section 31 would authorize the appropriation of $160 million to extend through 2013 a pilot program to reduce potential future damages to properties that have experienced repetitive losses through floods. In 2004, the Congress authorized $40 million a year for the pilot program to operate through 2009 and, in 2007, provided $50 mil-

lion through the National Flood Insurance Fund (NFIF) for this activity (see Public Law 109–295). The bill would continue that authorization level for fiscal years 2010 through 2013. CBO estimates that implementing this section would cost $72 million over the 2008–2012 period and an additional $88 million after 2012, subject to appropriation of the authorized amounts.

Over the next 10 years, some or all of such costs might be offset by lower claims payments, depending on the effectiveness of the mitigation efforts. CBO expects that such lower claims would have no effect on premium levels, but would result in additional amounts set aside in the reserve fund. Furthermore, savings from lower future claims cannot be attributed directly to this legislation because the size and duration of any mitigation program would depend on amounts provided in future appropriation acts.

Office of Flood Insurance Advocate. Section 32 would authorize the appropriation of $5 million a year over the 2008–2013 period to establish the Office of the Flood Insurance Advocate. The office would assist in resolving conflicts between policyholders and the NFIP and would propose changes in the administrative process to prevent future conflicts from occurring. CBO estimates that implementing this provision would cost $23 million over the next five years, subject to appropriation of the specified amounts to the National Flood Insurance Fund.

Studies. The bill would direct the Government Accountability Office to conduct several studies on the NFIP, including an annual report on the financial activities of the program. CBO estimates that conducting those studies would cost about $1 million over the 2008–2012 period, subject to appropriation of the necessary funds.

Participation in Claims Mediation. Section 26 would require FEMA to participate in state-claims mediation programs to help expedite the settlement of disputed flood insurance claims. The additional administrative costs of this provision are uncertain because it is unclear how the program would be implemented. If large staff increases were necessary, however, it is likely that the NFIP would increase the policy fee assessed on policyholders to cover this additional cost—resulting in no net cost to the federal government.

Intergovernmental and private-sector impact: The bill contains two intergovernmental mandates as defined in UMRA. It would require state agencies that regulate mortgage lenders to require that those lenders provide borrowers with information about flood insurance if the property covered by the mortgage is located in the 500-year floodplain. It also would require state agencies that offer direct mortgages to provide such information. Based on information from mortgage lenders, state regulatory agencies, and state housing authorities, CBO estimates that the cost for state regulatory agencies would be minimal and the number of loans for which state agencies would be required to provide flood insurance information would be small. The total cost for state agencies to comply with those requirements would be well below the annual threshold established in UMRA ($66 million in 2007, adjusted annually for inflation).

The legislation would impose private-sector mandates, as defined in UMRA, on certain mortgage lenders. Based on information from industry sources and FEMA, CBO expects the direct costs to comply with those mandates would fall below the annual threshold for

private-sector mandates established in UMRA ($131 million in 2007, adjusted annually for inflation).

The bill would require federally regulated mortgage lenders when making, increasing, extending, or renewing any loan secured by property located in an area within the 500-year floodplain to notify the purchaser or lessee and the servicer of the loan that such property is located in that floodplain. The bill also would require certain mortgage lenders to notify policyholders that insurance coverage may cease with the final mortgage payment and to provide direction as to how the homeowner may continue flood insurance coverage after the life of the loan. In addition, certain mortgage lenders would be required to deposit premiums and fees for flood insurance in an escrow account on behalf of the borrower. According to industry representatives, the cost for mortgage lenders to provide the additional notices and direction and to escrow flood insurance payments would be small.

Previous CBO estimates: On September 20, 2007, CBO transmitted a cost estimate for H.R. 3121, the Flood Insurance Reform and Modernization Act of 2007, as ordered reported by the House Committee on Financial Services. Both bills would modify the NFIP, but contain substantial differences that are reflected in the cost estimates.

Estimate prepared by: Federal Costs: Daniel Hoople; Impact on State, Local, and Tribal Governments: Melissa Merrell; Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: Theresa Gullo, Deputy Assistant Director for Budget Analysis.

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

This legislation seeks to address several gaps in coverage areas within the National Flood Insurance Program. Section 9 of this legislation requires states, as a requirement of participation in the program, to require state-chartered financial institutions to maintain flood insurance on all current and future mortgages starting December 31, 2008. This section will enhance safety and soundness of state-chartered financial institutions by ensuring that assets used to secure loan payments are sufficiently covered in the event that assets are damaged or destroyed by a flooding event. Section 10 updates the maximum allowable civil money penalties per violation that regulators may impose against financial institutions for failing to comply with the provisions of this Act. Section 10 also eliminates the $100,000 annual cap that regulators may impose on financial institutions to ensure compliance with this Act. Section 11 of this Act requires that all flood insurance payments are escrowed, which insures that flood insurance payments remain current and that assets used to secure loan payments are protected.

This legislation also requires the NFIP to keep and maintain a reserve fund of one percent of total risk exposure. This provision ensures that policyholders' claims will be paid without the assistance of the U.S Treasury and is also consistent with the goal of working to eliminate some portion of the $1.3 billion annual subsidy for the program.

It is expected that the reported bill will have no impact on the personal privacy of the current or prospective flood insurance policyholders. This bill is expected to strengthen the financial status of the NFIP by making rates more actuarially sound and expanding the population purchasing flood insurance. This bill also provides for more equitable treatment between policyholders as well as protecting the U.S. taxpayer from further loss.

CHANGES IN EXISTING LAW (CORDON RULE)

On October 17, 2007, the Committee unanimously approved a motion by Senator Dodd to waive the Cordon rule. Thus, in the opinion of the Committee, it is necessary to dispense with section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

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