

STATEMENT

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BEFORE
THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP
U.S. SENATE
NEW ORLEANS, LA

**“HOW FLOOD INSURANCE RATE INCREASES AND FLOOD MAPPING POLICY
CHANGES WILL IMPACT SMALL BUSINESSES AND ECONOMIC GROWTH”**

Submitted
By

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Introduction

Chairman Vitter, Ranking Member Shaheen and Members of the Committee, I am Brad Kieserman, Deputy Associate Administrator for Federal Insurance at the Federal Insurance and Mitigation Administration (FIMA) in the Department of Homeland Security's (DHS) Federal Emergency Management Agency (FEMA). I am grateful for the opportunity to be here today, and appreciate your partnership on flood insurance issues.

In this testimony, I will discuss the impacts of the National Flood Insurance Program (NFIP) on small businesses.

Flooding and the Need for a National Program

Flooding has been, and continues to be, a serious risk in the United States. Most insurance companies have historically excluded flood damage from homeowners insurance because of adverse selection – only those most susceptible to flooding will purchase coverage. To address this need, Congress established the NFIP in 1968 to make flood insurance available, identify flood risks and encourage sound local flood risk management. The NFIP is administered by FIMA.

The NFIP serves as the foundation for national efforts to reduce the loss of life and property from flood. The program identifies areas with risk of flood, mitigates the long-term risks to people and property from the effects of flooding, and makes insurance against the risk of flood generally available in participating communities. The NFIP works with participating private insurance companies – commonly known as “Write Your Own” companies – to market, sell, administer and adjust claims for policyholders. By encouraging sound floodplain management efforts, the NFIP is estimated to save the nation \$1.7 billion annually in avoided flood losses.

The NFIP was, by statute and design, not actuarially sound. Specifically, 20 percent of policyholders, including many of the NFIP's highest risk structures, paid premiums that were less than actuarially sound and the government was subsidizing on average 60 percent of the loss. This design, in addition to catastrophic flood events such as Hurricanes Katrina, resulted in an annual premium shortfall that required FEMA to use its statutory authority to borrow funds from the U.S. Department of Treasury. These funds were used to pay covered flood damage claims to policyholders. Although payments have been made to reduce this obligation, \$23 billion in debt remains.

Recent NFIP Reforms

In this context, Congress passed the Biggert-Waters Flood Insurance Reform Act of 2012 (BW12). BW12 required major changes to components of the program. Many of the changes were designed to strengthen the fiscal soundness of the NFIP by ensuring that flood insurance rates more accurately reflect the real risk of flooding. FEMA began phasing in the rate increases for certain subsidized properties in 2013. BW12 also authorized a flood mapping program, created the Technical Mapping Advisory Council (TMAC), created a reserve fund, and called for a study on the affordability of flood insurance.

In March of 2014, Congress passed and President Obama signed the Homeowner Flood Insurance Affordability Act (HFIAA) into law, repealing and modifying certain provisions of BW12, and making additional program changes to other aspects of the program not covered by that Act. Many provisions of BW12 remain in effect and are still being implemented. Like BW12, HFIAA requires changes to the major components of the NFIP, including flood insurance, flood hazard mapping, grants, and floodplain management.

Impacts on Small Businesses

The NFIP offers policies designed specifically for commercial policyholders, providing up to \$500,000 for building property, and up to \$500,000 for contents of the business. For many large businesses, the commercial coverage under the NFIP is not adequate to cover their needs. However, for many small businesses, affordable flood insurance provided by the NFIP is an important protection against flood losses.

The NFIP is in the process of implementing reforms required by BW12 and HFIAA. HFIAA repeals or modifies some provisions of BW12. However, HFIAA maintains the requirement that flood insurance rates for business properties in high-risk areas reflect true risk. This means that the subsidized rates that previously applied to some older business buildings will continue to be phased out.

On October 1, 2013, the subsidized rates for these pre-Flood Insurance Rate Map (pre-FIRM) buildings began to phase out. At renewal, non-residential policyholders received a 25 percent rate increase. As required by both BW12 and HFIAA, the 25 percent rate increases are set to continue until rates reflect the property's true risk. However, a provision of HFIAA temporarily slows that rate of increase. Currently, business properties and non-business, non-residential buildings such as schools, churches, hospitals, and apartment buildings are included within a single non-residential policy rating class. HFIAA caps increases for these other buildings at 18 percent per year. Until FEMA begins to separately classify businesses on April 1, 2016, all non-residential properties—including businesses—will receive no more than an 18 percent annual increase.

Increasing fixed costs for expenses such as flood insurance can have a negative impact on small businesses. While FEMA encourages all business owners to avoid locating a business on property susceptible to high or moderate risk of flooding, the NFIP recognizes that this is not always feasible for a variety of reasons. However, there are ways in which businesses can mitigate their flood risks and lower their insurance premiums. Options for business owners to consider include: floodproofing, relocation, floodwalls and levees, and structural elevations. Not every option will work for every business. We encourage businesses who want to mitigate against flood losses to work closely with their flood insurance agent and their state and community officials to evaluate their options.

Implementation of the Homeowner Flood Insurance Affordability Act of 2014

FEMA is aggressively implementing changes to the NFIP as required by Congress after the passage of HFIAA. FEMA completed issuing refunds as required by HFIAA in February 2015. Refunds were provided to policyholders to align their rates to the changes that Congress provided in HFIAA and to be no more than 18 percent per individual per year. The average

amount of refund was \$92.96 and the NFIP paid over \$65 million in refunds to policyholders. There are a limited number of policyholders who cancelled policies mid-term or moved that did not leave forwarding addresses that may have not received their refunds. We are working to get in touch with these people to provide their refunds. Additionally, FEMA is conducting a rigorous review of the refund data to ensure all eligible policyholders received refunds.

Policyholders eligible for a refund include:

- Policyholders who purchased or renewed policies on or after October 1, 2013 and were charged full-risk premiums for buildings constructed before FEMA issued flood insurance rate maps for a community (FEMA refers to these properties as pre-FIRM) because (1) the property was not insured when BW12 was enacted; or (2) the property was purchased after BW12 was enacted.
- Policyholders whose lapse in coverage was due to some property owners no longer being required to purchase flood insurance. HFIAA restores subsidies to policies for Pre-FIRM properties that were rated full-risk under BW12 due to a lapse in coverage where coverage was reinstated on or after October 4, 2014 (90 days after enactment of BW12).
- Some policyholders who purchased or renewed policies after March 21, 2014 and paid rates in excess of the new 18 percent rate increase cap per policy mandated under HFIAA.

Surcharges required by HFIAA went into effect on April 1, 2015. Upon renewal and for new policies, all policyholders will be required to pay \$25 for policies on primary residences and \$250 for all other policies. Surcharges are applied annually and are added on top of the no more than 18 percent per year annual increases. Congress instituted the surcharges with the passage of HFIAA to slow the rate of premium increases required by BW12. Surcharges will go into the NFIP reserve fund and can be used to pay claims and pay down the program's debt.

May 1, 2015 Bulletin Implementing Business Provisions

FEMA prepared a bulletin to be released on May 1, 2015 (today) that will implement the business provisions of BW12 and HFIAA. Starting November 1, 2015, the NFIP will have a new classification for business. Previously, all non-residential properties were classified in one category that included business, non-profits, and houses of worship. Once the business category is established, the WYO companies will work with the NFIP to re-underwrite an estimated 290,000 policies upon renewal. Some portion of the 290,000 properties currently classified as non-residential policies will be reclassified as business properties. Less than eight percent of our policies are non-residential and, therefore, I anticipate an even smaller percentage will be business properties.

Non-residential properties currently receive rate increases of no more than 18 percent per year until they reach the full actuarial rate. This rate will continue until March 31, 2016. Additionally, beginning, April 1, 2016, upon classification and underwriting as a business property, business properties will receive a 25 percent increase annually until they reach the full actuarial rate.

FEMA will then begin to capture data about businesses in the NFIP and we will complete the required study on the protection of small businesses, non-profits, houses of worship, and residences. This study is anticipated to be completed early 2017, as a one year data capture on the specific categories (small business, non-profits, houses of worship) is needed to complete the report.

Affordability Study

As required by BW12 and HFIAA, the National Academy of Sciences recently issued its Phase 1 report to define affordability concepts and outlined program policy options. The Phase 2 report is expected to be released in fall 2015, and will propose alternative approaches for a national evaluation of affordability program policy options. FEMA will issue an Affordability Framework within 18 months after the completion of the Phase 2 report. With the NFIP authorization expiring on July 7, 2017, we look forward to working with Congress to continue to reform the program, and ensure it is focused on policyholder recovery and disaster survivors.

Conclusion

Congress continues to be an active partner in providing direction to FEMA as we seek to implement a program that will serve the needs of individuals, businesses, and communities to help them protect themselves and their properties from flood risks as well as recover from flooding disasters. I look forward to our continued work together in finding better ways to protect against flood risks in Louisiana, and across the country.

Thank you again for the opportunity to appear before you today. I am happy to answer any questions you may have.