

POLITICS & POLICY

Storms Rattle Federal Flood Insurer

*As Claims Accumulate After Gulf Coast Hurricanes,
So Do Calls to Revamp Program*

By MICHAEL SCHROEDER

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HURRICANES THAT HIT the Gulf Coast also have battered the federal flood-insurance program, prompting a debate over whether the 37-year-old insurer needs an overhaul.

After Katrina and Rita, the National Flood Insurance Program has received almost 200,000 claims of damage to residential and commercial property and expects costs to approach \$23 billion. Hurricane Wilma will add billions of dollars more. The amount far exceeds the \$15 billion paid out over the program's entire history, and dwarfs the \$2 billion in premiums the program collects annually from policyholders in flood-prone areas around the country.

That means the program, which largely has been financed by premiums since 1986, will have to borrow from the U.S. Treasury Department, and since most loans won't be repaid, taxpayers will end up footing the bill. Unlike commercial insurance companies, the NFIP doesn't build reserves in good times to cover unusually large losses in bad times.

The program's finances, some lawmakers and critics say, underscore the urgency of revamping the NFIP and addressing a host of issues. What should be done to ensure that people who are required to have flood insurance actually have it? Should more property owners be ordered to get the insurance? And what should be done about the people who don't have insurance and lose their homes to floods?

The recent hurricanes have raised a "big public-policy question" about how to make the program financially sound, Senate Banking Committee Chairman Richard Shelby, an Alabama Republican, said at a recent hearing. Legislation to revamp the program is likely to come up next year. David Maurstad, NFIP's acting administrator, says the problems brought on by Katrina suggest that the program needs to be scrutinized.

Federal flood insurance was proposed by President Harry Truman after insur-

ers refused to cover major flood damage in Independence, Mo. Congress didn't create the program until 1968, a few years after Hurricane Betsy caused devastating flooding in the Florida Keys and Louisiana. Then, as now, privately sold homeowners' policies covered wind but not water damage from storm surges and other kinds of flooding.

Today, the NFIP, which is part of the Federal Emergency Management Agency, has 42 employees and relies on Computer Sciences Corp. to oversee 4.7 million federal policies valued at \$800 billion. The company has a new 27-month contract valued at \$35 million. The policies are marketed by 96 private insurance companies.

Property owners are required to buy the policies—which for residences can cover up to \$250,000 in structural damage and \$100,000 in lost belongings—if they meet two conditions: They live in the most flood-prone parts of more than 20,100 communities that participate in the NFIP, and they have mortgages from federally regulated banks or the Federal Housing Administration. But homeowners in flood-prone areas aren't required to buy policies if they don't have mortgages or if their mortgages are from state-chartered banks.

Program officials concede that it makes little sense to require some homeowners vulnerable to floods to buy the insurance, while letting others go without coverage. Moreover, less than 40% of property owners who are required to buy the insurance actually do so. In parts of Mississippi and Alabama hit hardest by Katrina, the coverage rate was only 15%. Much of the \$44 billion in total Katrina flood damage was to structures not covered by insurance, according to AIR Worldwide, a disaster-modeling firm.

NFIP's Mr. Maurstad says many people traditionally haven't bought flood insurance because they believe their biggest risk—basement water damage—doesn't justify the costs. Premiums average \$438 a year for maximum coverage, but can run as high as \$25,000 for some beachfront properties.

Another problem, officials say, is en-

forcing the insurance mandate. While federally chartered banks have a good record of ensuring that owners get required policies, critics say, they are less successful in making sure the policies are maintained year after year. An estimated 15% of total NFIP policies lapse each year because property owners don't pay premiums. Also, mortgage originators frequently sell their loans to other institutions which don't monitor insurance requirements. And 35% of flood-plain properties are bought without loans.

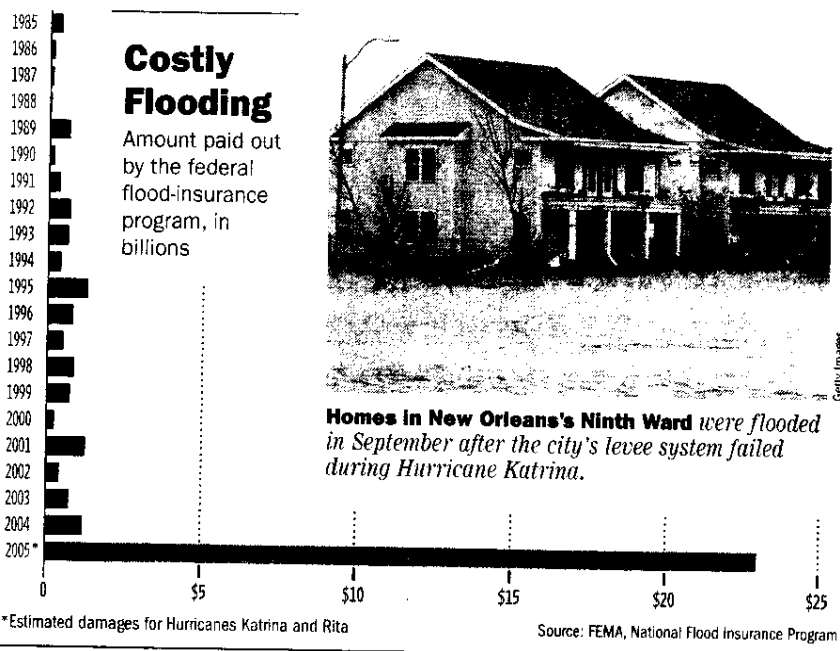
Robert Hartwig, chief economist at the Insurance Information Institute in New York, says banks should be compelled to verify that "flood coverage is in force at all times" for required properties and should face stiffer penalties if they don't. In the past decade, regulators have fined banks only \$800,000 for violations, flood-insurance program officials say.

Mr. Hartwig also says that all mortgage lenders, including state-chartered banks, should be required to ensure that property owners in flood plains have insurance. Enforcing the insurance requirement is likely to become an even bigger issue in coming years, as the NFIP overhauls flood-plain maps, which haven't been updated in a decade. The new maps are expected to show more homes and commercial buildings are located in flood plains. "It's clear improvements are needed in the entire system," says Aaron Albright, a spokesman for the American Bankers Association, while stressing the importance for FEMA to update flood-plain maps.

Some lawmakers, including Mr. Shelby, suggest that the NFIP should be restructured to operate more like a private insurance company. A first step may be for Congress to direct the program to deny coverage to properties that are repeatedly flooded, they say.

Some insurance experts say the program should set higher premiums to build surplus revenue for unexpected events like Katrina. There is also pressure to roll back the premium subsidies, valued at about \$800 million a year, that go to the 25% of policyholders whose properties were built before the program's creation. But Mr. Maurstad says any move to sharply raise premiums could result in more policyholders forgoing flood insurance altogether.

J. Robert Hunter, director of insurance



for the Consumer Federation of America, says he is concerned that the private insurance companies that sell the policies for the government aren't giving consumers correct information. Some residents have complained that their insurance agents wrongly told them that homeowners' policies would cover flood damage and that flood insurance wasn't needed.

Yet another issue involves whether people without flood insurance should be compensated for their losses. Rep. Gene Taylor, a Mississippi Democrat, has proposed legislation that would allow homeowners living outside flood zones to buy into the national insurance program retroactively.

Mr. Taylor's bill, however, has gotten little support. Mr. Maurstad said that the proposal is a "bad idea" that would gut the insurance program by providing a disincentive for people to buy flood insurance.