Secretary
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

April 24, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20510

Dear Chairman Frank:

This letter provides the Administration's views on reauthorization of the National Flood Insurance Program (NFIP). During the 110th Congress, the House of Representatives passed H.R. 3121, the *Flood Insurance Reform and Modernization Act of 2007*. The Senate amended that bill with a complete substitute. A conference on the competing versions did not take place, and Congress ultimately authorized a seven-month extension of the program until March 6, 2009 (Public Law 110-329). Since then, the program has been reauthorized through September 30, 2009 by the *Omnibus Appropriations Act of 2009* (Public Law 111-8).

The Administration supports meaningful reforms to the NFIP and reauthorization of the NFIP through Fiscal Year 2014. The Administration strongly believes that any legislative measures aimed at reforming the NFIP must address the debt incurred from Hurricanes Katrina, Rita, and Wilma in 2005. The Administration has serious concerns with provisions in the bills passed last year that mandate Federal Emergency Management Agency (FEMA) participation in state-sponsored mediation programs, the establishment of an unnecessary flood insurance advocate, as well as the additional provision for multiple-peril insurance contained in the House bill. These concerns are discussed in detail below.

The Administration supports the following elements, which were contained in the Senate and House bills:

- Phase-in actuarial rates for nonresidential properties, non-primary residences, and repetitive loss properties;
- Raise the cap on chargeable annual increases in premiums from 10 percent to 15 percent;
- Authorize an ongoing program to review, update, and maintain flood insurance program maps; and
- Reestablish the Technical Mapping Advisory Council, the duties of which would include developing recommendations for improvements to the flood mapping program.

NFIP Debt Forgiveness

The Administration strongly supports forgiveness of the current debt resulting from the 2005 hurricane season. As of January 31, 2009, the NFIP had incurred a debt of $19.2 billion. The National Flood Insurance Fund (NFIF) has and continues to make interest payments from both premium and borrowed funds and, as indicated in previous testimony before the Senate Banking, Housing, and Urban Affairs Committee and House Financial Services Committee, it is unlikely that the NFIP will ever be able to retire this debt. The debt load has had a significant impact on NFIP financial operations. Had the program not been obligated to make interest payments, the NFIP could have covered all losses from events subsequent to the 2005 hurricanes, including the 2008 floods and hurricanes, without having to borrow the $1.68 billion to pay losses from these events. The result is that the program has had to borrow more to pay interest on the debt, further compounding the situation.

As originally conceived, the NFIP was the means to encourage communities and citizens to understand their risk from flooding and mitigate against future flood damage. Congress provided the incentives to do this by encouraging community participation, discounting premiums for Pre-FIRM structures (structures built prior to the issuance of Flood Insurance Rate Maps), mandating the purchase of flood insurance in Special Flood Hazard Areas, and authorizing grant programs to mitigate repetitively damaged structures. The NFIP's flood risk identification and floodplain management land use and building standards will have reduced the costs and consequences of flooding by a conservative estimate of $16.3 billion from 2000 through 2010. This amount does not include the considerable savings achieved as a result of the program prior to 2000. It would be difficult to comprehend how enormous the costs of flooding would be for all levels of government and citizens if these standards were not in place.

The NFIP's financial position is similar to the Nation's financial position, by which its obligations exceed its income. This can be dealt with in a systematic way through debt forgiveness or the debt can continue to grow until all of the NFIP's income must be used to service the debt. The Administration is asking for debt forgiveness because the size of the current debt creates an unstable financial situation for the NFIP and the subsidized insurance premium structure does not and will not allow the NFIP to collect enough to service the debt or repay it. Without continuing to borrow to service the debt, the NFIP cannot pay the expenses of operating the insurance program, fund map modernization efforts, or support flood mitigation programs.

Because Congress chose to provide a subsidy to Pre-FIRM structures, the NFIP's premium rates are by statutory definition inadequate. Over the long term, the Program should expect to need to borrow from the Treasury from time to time. Those times would generally occur after major catastrophic flooding events such as Hurricane Katrina. While those incurred debts could possibly be repaid during periods of moderate flooding activity, such as the period from 1985 to 2004, such periods should be expected to be temporary. Once the debt has reached a very high level—such as the current debt of close to $20 billion—there is no realistic prospect that the NFIP could ever repay it.

Should debt forgiveness be included in any legislation reauthorizing the NFIP, an appropriation should be made to FEMA in the amount of the current market value of the loans to be forgiven, which would then be transferred to the U.S. Department of the Treasury. This transaction would make the cost of the debt forgiveness transparent and will ensure that this cost is properly accounted for by FEMA. This would have no budget scoring impact because it would simply be an intra-governmental transfer.

If the debt were forgiven, the Administration would propose tying future borrowing authority to insurance exposure, so the Program's authority to borrow would be related to its contingent liabilities, not to the arbitrary amount that was included in the original legislation. The Administration supports indexing the borrowing authority cap to 0.5 percent of the total amount of NFIP insurance-in-force at the prior fiscal year's end. This formula would result in a current borrowing authority cap of about $5 billion based on the approximately $1 trillion of insurance-in-force. This suggested percentage is based on our review of expected losses during a period of increased hurricane activity and would provide a sufficient borrowing margin so that requests for increases in the cap should rarely be needed, while still allowing a reasonable opportunity for the NFIP to retire any incurred debt up to that level. The Senate version of the reform bill that was before the last Congress contained a provision that restored the borrowing authority to $1.5 billion.

Participation in State Disaster Claims Mediation Programs

The Administration has significant constitutional concerns regarding provisions in the bills that would require FEMA claims adjustors to participate in state-sponsored mediation at the request of state insurance commissioners. The Constitution carefully allocates power among the branches of the Federal Government and between the states and the Federal Government, and it does not permit Congress to confer upon state officials the authority to compel agents and programs of the Federal Executive Branch to be subject to states' authority. Stated differently, this provision would violate constitutional principles, articulated by the Supreme Court, prohibiting Congress from delegating Federal executive power to individuals outside of the executive branch.

Flood Insurance Advocate

There are also constitutional concerns regarding the provision in the Senate bill that would require a "National Flood Insurance Advocate" to provide reports directly to Congress without any prior review by executive branch officials. By precluding review and approval by the FEMA Administrator, the Secretary of Homeland Security, and the Office of Management and Budget, the provision would interfere with the President's authority under Article II of the Constitution to supervise and control the internal operations and procedures of the Executive Branch (see *Myers v. United States*, 272 U.S. 52, 132-34 (1926)). Although the Senate bill did not prohibit contemporaneous review of the report by the President, this does not change the constitutional analysis. The constitutional concerns with this provision are heightened insofar as the National Flood Insurance Advocate's report may contain legislative recommendations. Moreover, to the extent that the powers and authorities given to the National Flood Insurance Advocate under the bill—most notably the authority to "enter into contracts" of various types with appropriated Federal funds—would entail the

exercise of delegated sovereign authority, the provision for his or her appointment would conflict with the requirements of the Appointments Clause of the Constitution.

Additionally, this provision would add a new, expensive bureaucracy within FEMA, paid for directly from the NFIF without collecting offsetting revenues from policyholders and would be duplicative of processes already available to policyholders through the NFIP's formal appeals process as set forth in 44 C.F.R. § 62.20(f) and in the in the *NFIP Flood Insurance Claims Handbook.*

Multiperil Coverage for Flood and Windstorm

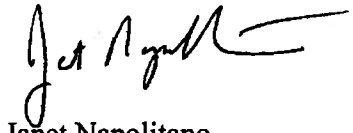
The Administration strongly opposes the provision in the House bill establishing insurance coverage for multiple perils. The Administration objects to this coverage for a number of reasons:

- Coverage is available in the private sector and through state wind pools. Property owners are served by the private market, which provides catastrophic windstorm coverage without the need for Federal aid. The Administration opposes extending the Federal Government's role and increasing its liability for an insurance program that is readily available in the private sector and through state insurance plans. Many carriers in Florida have told the state's insurance regulator that they would write the wind policies of insurers withdrawing from the state.
- Voluntary Federal wind coverage would create significant problems involving coordination of benefits and adversely affect competition and selection among the various public and private wind programs.
- Wind coverage would greatly increase the NFIP's exposure to catastrophic risks at a time when the program has a growing debt and accrued interest of over $19 billion;
- The legislation requires Federal wind insurance to be actuarially sound, as it should; hence, the insurance offered through a Federal program will not be less expensive than what is available in the private insurance market.
- The requirement to discontinue the multi-peril coverage whenever borrowing occurs could lead to shutting down the program.
- Unless communities adopt the international building codes without amendments, FEMA would be forced to review thousands of community building codes every three years and continuously monitor them to ensure compliance.
- Building codes and standards do not dictate land use and zoning requirements, which have always been reserved for states to decide what is appropriate. The term 'windstorm' includes any hurricane, tornado, cyclone, typhoon, or other wind event, yet American Society of Civil Engineers Minimum Design Loads for Buildings and Other Structures (ASCE 7-05), and the Nation's model building codes do not address tornadoes.

In summary, the Administration looks forward to working with Congress to reform and strengthen the NFIP for the benefit of policyholders and taxpayers. The Administration believes that any reform or reauthorization legislation should address the NFIP's debt and financing and avoid expanding the program to cover new non-flood-related areas. Any National Flood Insurance Program reform should include a phase-in of actuarial rates, subsidy reduction, an increase in the annual premium rate cap, authorization of a mapping program, and re-establishment of the Technical Mapping Advisory Council as core elements.

Thank you for the attention to the views in this letter. An identical letter has been sent to the Ranking Member of the House Committee on Financial Services, and the Chairman and Ranking Member of the Senate Committee on Banking, Housing, and Urban Affairs. Should you wish to discuss this matter further, please do not hesitate to contact me at (202) 282-8203.

Yours very truly,



Janet Napolitano