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TESTIMONY OF

THE HONORABLE GENE TAYLOR

MEMBER OF CONGRESS,

4TH DISTRICT OF MISSISSIPPI

BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

"LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM"

APRIL 21, 2010

Thank you, Madam Chairman, for holding this hearing and for all of your assistance to me and the people of Mississippi and Louisiana since Hurricane Katrina. I know that you personally have been to the Gulf Coast at least three times to hold field hearings and to meet with local citizens, and I sincerely appreciate your efforts and support for our recovery.

As you know, the House passed a very good flood insurance reform bill in 2007 that included my legislation to create an option for coastal property owners to buy wind and flood insurance from the National Flood Insurance Program. The Housing Subcommittee under Chairman Waters and the Oversight and Investigations Subcommittee then under Mr. Watt held six hearings about the handling of Katrina insurance claims and about the need for a much better insurance option to cover hurricane losses.

Unfortunately, we were not able to convince the Senate or the Bush Administration to take the issue seriously, so the House reform package died at the end of the 110th Congress. We are back three years later. The fundamental problems in the flood

program still have not been addressed and the coastal insurance crisis has spread to more states.

There are three simple reasons why coastal residents, federal taxpayers, and state governments need Congress to enact H.R. 1264, the Multiple Peril Insurance Act.

First, home owners and business owners in coastal communities need to be able to buy hurricane insurance that will cover hurricane damage without needing to hire lawyers and engineers to engage in prolonged disputes over what portion of the damage was caused by flooding and what portion was caused by wind. As long as wind and flood coverage are in separate policies, there will be gaps in coverage and disputes over causation after hurricanes.

Second, federal taxpayers need coastal home owners and business owners to pay premiums for hurricane insurance that will promptly and efficiently cover hurricane losses so that the taxpayers do not have to pay billions of dollars in rental assistance, FEMA trailers, home repair grants, subsidized loans, and tax deductions after a hurricane. Every property loss that is uninsured or for which payment is delayed or denied, ends up being subsidized in some way by federal disaster assistance.

Third, the Gulf and Atlantic states need the federal government to set up a hurricane insurance pool that will spread hurricane insurance exposure over a large geographical area to replace the state-by-state pools that concentrate the exposure in local areas. In just the past four years, insurance companies have dumped more than $300 billion in coastal insurance exposure into state-sponsored high-risk pools. These single-state pools cannot build up sufficient reserves for a major hurricane that would hit a large portion of the pool at one time.

Under the current insurance system, the National Flood Insurance Program relies on insurance companies to sell federal flood insurance policies. That is a good idea because then we do not need to hire federal insurance agents. However, GAO has found that NFIP overpays insurance companies by hundreds of millions of dollars in administrative subsidies. Congress should enact all ten GAO recommendations to reduce the administrative payments and to improve the oversight and accountability of the operating subsidies paid to the Write Your Own companies.[1]

Unfortunately, that is the least of NFIP's problems caused by its failure to provide adequate oversight of the insurance companies. The flood program also allows the insurance companies to adjust flood claims after a hurricane and determine how much damage to blame on flooding and bill to the federal taxpayers and how much damage to blame on wind that is covered by the insurers' own policies. GAO correctly described this arrangement as an "inherent conflict of interest."[2]

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[1] U.S. Government Accountability Office (GAO), *Flood Insurance: Opportunities Exist to Improve Oversight of the WYO Program,* GAO-09-455 (Washington, D.C.: August 2009).

[2] GAO, *National Flood Insurance Program: Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed,* GAO-08-28 (Washington, D.C.: December 2007).

GAO also found that FEMA did not require the insurance companies to explain their procedures for identifying, apportioning, or quantifying the damages caused by flood or wind on properties that experienced both perils. GAO recommended that Congress give FEMA clear statutory access to the wind claims files for properties with both wind and flood damage, and require the insurance companies to document their procedures for adjusting cases where both perils contributed to the damage.[3]

I urge Congress and the Administration to enact the GAO recommendations but I do not believe that they go far enough. The "inherent conflict of interest" that insurance companies have under the current system cannot be managed or mitigated.

In fact, the GAO report barely scratched the surface of the many ways that insurance companies shifted their liabilities to the federal taxpayers. Several of the largest insurers in the country implemented an extreme interpretation of their "Anti-Concurrent Causation" clauses, attempting to deny any coverage of wind damage if flooding also contributed to the damage later.

Two weeks after Katrina, State Farm sent a memo to its adjusters with the instruction that "Where wind acts concurrently with flooding to cause damage to the insured property, coverage for the loss exists only under flood coverage."[4]

State Farm's adjusters spent the first month after the storm driving around South Mississippi handing out flood insurance checks from federal taxpayers, but made no attempt to determine the amount of wind damage or to prove the amount of flood damage. When State Farm did send engineers to estimate the cause of damage at some of those properties, the engineers were given instructions that they not divide the loss between wind and flood, and coerced and threatened them to blame it all on flooding.

These tactics and actions have been exposed in case after case after case in the past four years, but NFIP, FEMA, the Department of Homeland Security, and the Department of Justice have done nothing to step up and protect policyholders and taxpayers.

Although the interpretation of Anti-Concurrent Causation language was the central legal issue in thousands of cases, it took four years of delays, appeals, and settlements, before we finally received a definitive legal interpretation by the Mississippi Supreme Court. In *Corban v. USAA*, the state Supreme Court ruled that damage caused by wind before any flood damage should be covered by the wind insurance policy, not by the flood insurance policy. The Court also confirmed that the insurance company has the burden to prove that the loss is excluded or else pay the claim.

During oral arguments in the *Corban* case, Nationwide was permitted to appear as an interested party. Nationwide's attorney, Christopher Landau, argued that the sequence

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[3] GAO, *National Flood Insurance Program: Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed,* GAO-08-28 (Washington, D.C.: December 2007).

[4] *Wind/Water Claim Handling Protocol* memorandum to State Farm Claim Associates handling CAT PL in the Central and Southern Zones from Property and Casualty Claim Consulting Services, September 13, 2005.

of the wind and flood damage did not matter because of the Anti-Concurrent Causation clause.

Mississippi Supreme Court Justice Randy "Bubba" Pierce had this exchange with Landau: [5]

> JUSTICE PIERCE: So you're sequencing, if 95 percent of the home was destroyed, and then we have the event of the storm surge, then you would not pay a dime?
>
> MR. LANDAU: Your Honor, if we prove that the storm surge was sufficient to cause - we have that burden, again, and that is absolutely crystal clear.
>
> If we can prove that the storm surge was sufficient to cause all of this, it is no answer then to say, 'Yeah, but I'm going to show it -- I'm going to have somebody come in and say, "Look, guess what, the window was broken before the storm surge came and then wiped away the whole house.
>
> But you don't get into those kinds of issues precisely because of the sequencing of the damage.
>
> JUSTICE PIERCE: So you wouldn't pay a dime?
>
> MR. LANDAU: If - again, we wouldn't pay a dime for things where we can carry our burden, which is right there in the policy, of showing that the loss was caused concurrently –
>
> JUSTICE PIERCE: I'm giving you -- the example is 95 percent of the home is destroyed, the flood comes in and gets the other five percent, and you know that.
>
> Does your interpretation of the word "sequence" mean you pay zero?
>
> MR. LANDAU: Yes, your Honor.

It took four years to officially reject that ridiculous argument and get a common sense interpretation of the most important point of law because the insurance companies were able to move the thousands of cases to federal court and then bog down those courts with motions about anything and everything except the facts and the law central to the cases. Whenever it appeared that a case might come to trial and provide a useful precedent for other cases, the defendant insurance company would settle it confidentially.

While I have great respect and admiration for Judge L.T. Senter, Jr., who has spent the past four and half years dealing with many of these cases in South Mississippi, the fact is that the federal court system failed after Katrina. The insurance companies have been allowed to carry out an obvious legal strategy whose goal was to delay disaster victims their day in court in order to wear them down so they would accept settlement offers.

Many of the people who were denied coverage eventually reached settlements with their insurance companies, but the years of denials and delays were very costly to the federal

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[5] Oral Arguments before the Mississippi Supreme Court, *Corban v. USAA*.

taxpayers. Congress and the federal government did not sit idly by while hundreds of thousands of citizens were left homeless by Hurricane Katrina.

While many people have commented about the fact that the National Flood Insurance Program paid more than $16 billion in claims from Hurricane Katrina, almost no one has noted the fact that the federal government spent more than twice that much, 34.5 billion dollars, providing rental assistance, FEMA trailers, grants, and loans for home repairs.

Federal Disaster Housing Assistance to Residents Displaced by Katrina

FEMA Housing Assistance Payments[6]	**$4,287,388,698**
FEMA Manufactured Housing Costs[7]	**$7,172,714,484**
HUD CDBG Housing Grants[8]	**$15,437,876,000**
SBA Disaster Home Loans[9]	**$7,610,787,000**
TOTAL HOUSING ASSISTANCE	**$34,508,766,182**

A significant part of those costs should have been paid by insurance or could have been avoided if residents had insurance policies that would have covered their hurricane losses without disputes or gaps in coverage.

Homeowners insurance policies generally have coverage for "loss of use" or "additional living expenses" that will provide some amount of temporary living expenses if a policyholder is displaced because of a covered loss. When the insurance companies denied wind coverage, the denial also precluded coverage of living expenses. The flood insurance program does not provide coverage for loss of use or business interruption. Those coverages should be added to NFIP.

With many people displaced by Hurricane Katrina, FEMA immediately provided $2,000 per household. Because of the scope and severity of the property losses from Katrina, FEMA housing assistance grew into a long-term rental assistance program that ended up costing almost $4.3 billion.

In mid-September of 2005, President Bush came to New Orleans and announced that the federal government would provide a trailer to anyone who lost their home from Katrina. FEMA eventually paid more than $7 billion to provide 140,000 trailers. Many of the 42,000 trailers in Mississippi provided temporary housing for residents whose insurance claims had been denied and were waiting for their day in court.

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[6] FEMA, *Disaster Relief Fund: Monthly Status Report, Fiscal Year 2010 Report to Congress,* March 15, 2010.
[7] *ibid.*
[8] GAO, *Gulf Coast Disaster Recovery: Community Development Block Grant Program Guidance to States Needs to Be Improved,* GAO-09-541 (Washington, D.C.: June 2009).
[9] Bruce R. Lindsay, Congressional Research Service, unpublished data from SBA

In the meantime, many homeowners who had uninsured or insured-but-unpaid losses, took out low-interest disaster loans from SBA to repair or rebuild their homes. SBA made more than 100,000 disaster home loans for a total of $7.6 billion in Louisiana, Mississippi, and Alabama.

In the December 2005 Supplemental Appropriations Act, Senator Thad Cochran of Mississippi helped get the first appropriation for the Community Development Block Grant funds that would become the Road Home Program in Louisiana and the Homeowner Assistance Grant program in Mississippi. The concept for that program originated in the House Financial Services Committee with then-Ranking Member Barney Frank and his staff helping me draft a bill to provide assistance for the thousands of people whose homes flooded but who did not have flood insurance at least in part because they were not in a Special Flood Hazard Area according to the flood insurance maps.

Our bill would have paid disaster assistance to these homeowners through the National Flood Insurance Program in exchange for a covenant attached to the deed requiring flood insurance in perpetuity. Our proposal was opposed by the Bush Administration and Republican House leaders, but Senator Cochran was able add CDBG funds so that the states could create their own housing assistance programs.

While both states obligated residents to purchase flood insurance as a condition of the grants, I am concerned that neither the states nor the NFIP are actively enforcing the requirement.

In Mississippi, Phase I of the Homeowners Grant awards were based on the amount of uninsured loss, but capped at the amount of homeowners insurance in force at the time of Katrina. This was designed to assist homeowners who believed that they had insured their properties for a hurricane. However, this program served to take a lot of the pressure off of the insurance companies to pay on their wind claims.

The Road Home Program in Louisiana was a larger program with different criteria, but it also relieved a lot of pressure on the insurance companies by proving grants for uninsured or unpaid losses of people who did not collect in full on their insurance policies. Overall, the CDBG grant programs provided more than $15.4 billion in housing assistance grants, almost as much as the total of flood insurance claims payments.

Those four programs, rental assistance, FEMA trailers, SBA loans, and CDBG grants total more than $34.5 billion in direct assistance to homeowners and displaced renters. There also were billions of dollars of casualty loss tax deductions and other tax relief for homeowners. In additions, FEMA has provided billions of dollars of assistance to local governments and Congress has waived the local cost-shares and provided for the forgiveness of Community Disaster Loans because the property tax base still has not recovered. A large portion of those federal costs are the direct result of the gaps in insurance coverage.

The spokesmen for the insurance industry defend its performance by saying that insurers paid more than $41 billion in claims from Katrina. What they rarely admit is that the majority of the money was paid on large commercial claims, including some big business interruption claims because the oil and gas industry was shut down for a few weeks. It is great that those businesses were paid, but those claims are irrelevant to the discussion about the handling of homeowners wind and flood claims. The itemization of the insurance claims payments and federal assistance in Mississippi shows that the aggregate numbers are very misleading.

Payment Source	Number	Total Payments	Average
NFIP Claims Paid[10]	17,464	$2,439,649,984	$139,696
CDBG Homeowner Grants[11]	27,741	$2,158,364,059	$77,804
SBA Disaster Home Loans[12]	31,243	$2,069,160,000	$66,228
FEMA Trailers[13]	42,000	$1,596,628,569	$38,015
Homeowners Claims[14]	355,000	$5,475,000,000	$15,423

Insurance companies paid billions of dollars in homeowners claims, but the average claim in Mississippi was a little over $15,000, not even half the federal government's cost to provide a FEMA trailer. Katrina was a very large hurricane with high winds that caused property damage over a large multi-state area. Insurance companies paid Katrina homeowners claims in all 82 counties in Mississippi, all over Louisiana and Alabama, and in parts of Florida, Georgia, and Tennessee. Insurers paid 40,000 claims in the Jackson Metro area, 150 miles north of the Gulf of Mexico. Yet in the relatively narrow area along the Gulf, where the hurricane winds were much stronger and for a longer period of time, some insurance companies insisted that the winds had not been strong enough to cause more than superficial damage. There were very few lawsuits against insurance companies inland where there was no flooding. The problems were along the Coast where properties suffered both wind and flood damage.

Mississippi accounted for 17,464 of the 166,973 NFIP claims paid on Hurricane Katrina flooding; only 10.4% of the claims, but those claims accounted for 15.5% of the payments, because almost every NFIP claim in Mississippi was a total loss. There are several reasons why the average NFIP claim in Mississippi was almost $140,000.

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[10] FEMA, *Disaster Relief Fund: Monthly Status Report, Fiscal Year 2010 Report to Congress,* March 15, 2010.
[11] Mississippi Development Authority, unpublished data, April 16, 2010.
[12] Bruce R. Lindsay, Congressional Research Service, unpublished data from SBA
[13] FEMA, *Disaster Relief Fund: Monthly Status Report, Fiscal Year 2010 Report to Congress,* March 15, 2010.
[14] Robert Hartwig, Insurance Information Institute, *Catastrophes, the Credit Crisis & Insurance Cycle,* Ole Miss Insurance Symposium, March 26, 2008.

The first reason, of course, is that Katrina's storm surge was unprecedented in height and scope. The surge was more than 30 feet above sea level in Bay St. Louis, Waveland, and Pass Christian, but still more than 20 feet above sea level in Pascagoula, 60 miles east of the eye of the storm. The storm surge caused severe damage to the homes near the Gulf of Mexico that were 20 feet or less above sea level. Those homes also experienced several hours of high hurricane-force winds before the storm surge, so they should have been able to collect on both policies.

The second reason that the Mississippi NFIP claims payments were so high was the lack of adequate oversight of the insurance companies handling of the claims. There were thousands of NFIP policies on homes that were located on the bays, bayous, and rivers near the Gulf. Those properties flooded but the flood levels were not as high and did not have the force of the storm surge on the Gulf. Many of these cases had roof and structural damage from wind and wind-driven debris and also several feet of flooding. More importantly, they also had enough physical evidence remaining for a proper adjustment of the losses from wind and flooding.

Some of these cases have been the subject of prolonged legal disputes, and in almost every one that has become public, the insurance company immediately paid the policy limits on the flood policy without a detailed adjustment and then used the acceptance of the flood check against the homeowners when they tried to collect on the wind claim. It is almost certain that NFIP overpaid on dozens if not hundreds of these flood claims, but as GAO pointed out, FEMA did not ask the insurance companies to explain how they divided the wind loss from the flood loss.

The third reason that the Mississippi NFIP claims average was so high was because the flood insurance maps were horrible. The flood maps at the time of Katrina estimated that the 100-year flood on the Mississippi Gulf Coast was 12 or 13 feet above sea level. As a result, many homeowners whose homes were 16, 18, 20, or more feet above sea level were led to believe that they did not need flood insurance. Thousands of homes from several blocks to several miles inland had a few feet of flooding resulting in $25,000 or $50,000 or $75,000 in reparable losses, but did not have flood insurance. Those properties accounted for most of the CDBG Homeowners Grants, which had an average grant of $77,800.

The Flood Insurance Rate Maps in Mississippi were not storm surge maps. Back in October of 2005, the first time I testified about Katrina in this subcommittee, I came with posters to show the difference between the flood insurance map, which showed that very little of City of Gulfport in the flood hazard area, and the evacuation map based on data from NOAA and the Corps of Engineers, which identified many more flood-prone areas. If the flood insurance map had been based on the same data as the evacuation map, many more people would have had flood insurance coverage and would have paid premiums, and many more homes would have been elevated a few feet off the ground and had less damage.

There is one simple reform that would make sure that more future hurricane damage will be covered by insurance premiums and less disaster assistance would be needed

from the federal government. That reform is our legislation, H.R. 1264, to offer wind coverage as option with federal flood insurance. The program would close the gaps and uncertainties in hurricane coverage. It would eliminate the insurance companies' conflict of interest when handling hurricane flood claims. It would make future recoveries much faster and more efficient for homeowners, communities, and for federal taxpayers.

Since Katrina, insurance companies have abandoned coastal communities, creating an urgent insurance crisis along the Gulf Coast and Atlantic. State-sponsored high-risk pools have billions of dollars of hurricane exposure but are not able to build up enough reserves to cover a major hurricane that would result in a large volume of claims at one time.

Four Year Increase in Insurance Exposure in Selected State Insurance Pools

State Risk Pool	Dec 2004 Exposure	Dec 2008 Exposure	Change
Florida Citizens[15]	$202.8 Billion	$436.8 Billion	+115%
North Carolina Beach Plan[16]	$31.6 Billion	$73.5 Billion	+132%
Texas Wind Pool[17]	$20.8 Billion	$58.6 Billion	+182%
South Carolina Wind Pool[18]	$6 Billion	$17 Billion	+184%
Mississippi Wind Pool[19]	$1.6 Billion	$6.3 Billion	+283%
Alabama Beach Pool[20]	$337 Million	$1.8 Billion	+448%
Georgia FAIR Plan Wind[21]	$565 Million	$2.1 Billion	+265%

The insurance industry has fled and they will not come back. If some of them do come back to coastal markets, history has shown that they will flee again after the next major disaster. Some insurance executives have admitted that the private insurance model will not work for low-frequency, high-severity events, such as major floods, major hurricanes, or major earthquakes.

Research by Dr. Howard Kunreuther and Dr. Erwann Michel-Kerjan at the Wharton Risk Management Center at the University of Pennsylvania found that catastrophe insurance premiums in the highest risk areas can be five to ten times higher than the expected claims losses.[22]

Other researchers have also found that insurance premiums in coastal areas are several times higher than the claims they expect to pay. The reason they have to charge such

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[15] https://www.citizensfla.com/
[16] http://www.ncjua-nciua.org/html/fin.htm
[17] http://www.twia.org/AboutTWIA/PublicFinancialInformation.aspx
[18] http://www.scwind.com/members2.htm
[19] http://www.msplans.com/MWUA/Index.htm
[20] https://www.alabamabeachpool.org/pages/quarterly_reports
[21] http://www.georgiaunderwriting.com/index_files/Page345.htm
[22] Howard Kunreuther and Erwann Michel-Kerjan, *Managing Large-Scale Risks in a New Era of Catastrophes,* Wharton Risk Management Center, University of Pennsylvania, 2008. p. 141.

high premiums is that every year they have to account for the large amount of capital that would be needed if a major hurricane hits. In order to acquire or account for that much money, they have to pay high returns each year to attract capital investors or they have to buy reinsurance from reinsurance companies that pay high returns each year to attract capital investors. In either case, most of the resulting insurance premiums go to pay investors, not to pay future insurance claims.

Economist Lloyd Dixon of the RAND Corporation has explained the advantage of a government insurance program in high-risk areas:

> *"Government is not subject to the private-sector factors that produce large swings in premiums around expected loss in private insurance markets. Thus, compared with the private sector, government should be able to set insurance prices closer to expected loss for hurricanes and other catastrophic risks, and keep those prices closer to expected loss over time.*[23]

The federal government should be able to establish a hurricane insurance program that would spread risk geographically along the Gulf and Atlantic states. The federal program would be able to set rates based on the risk and create a stable insurance market. It would be very easy for the new program to determine wind risk and set wind premiums, because the state governments, the building industry, and the insurance industry have already done most of the work for them. For example, this is how the Mississippi Wind Pool sets its rates.

The Mississippi Wind Pool is the wind insurer of last resort for the three counties on the Gulf of Mexico and the three counties directly above those. The wind pool divides the territory into four rate zones:

Zone A – Between the Gulf of Mexico and the CSX Railroad
Zone B – Between the CSX Railroad and Interstate-10
Zone C – From I-10 north to the county lines
Zone D – The second tier of counties above the coastal counties

Within each zone, the wind pool board establishes risk-based rates for frame construction and masonry construction with several policy options for higher or lower deductibles. The wind pool also has a program that grants premium reductions for structures that meet a high wind-load mitigation standard.

The zones, the rates, and the mitigation credits are based on plenty of available data from the American Society of Civil Engineers, the International Code Council, and many other interested parties who study wind risk and building performance.

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[23] Lloyd Dixon, James Macdonald, and Julie Zissimopoulos, *Coastal Wind Insurance in the Gulf States,* RAND Gulf States Policy Institute, 2007, p. 8.

Other states with wind pools have established wind risk zones in similar manner, often using any easily identifiable and unambiguous feature to divide the zones. The Texas wind pool uses the Intracoastal Canal to divide the highest risk zone from the second zone.

Wind risk is much easier to determine and to map than is flood risk. The probability and severity of hurricane winds is much more predictable than the storm surge or the amount of rainfall, and the wind risk does not constantly change with any change in topography as flood risk does. Also, of course, wind insurance does not have to make assumptions about the performance of levees, dams, pumps, or other flood control structures.

The only problem that we would have setting up the new Multiple Peril Insurance Program would be dealing with the existing problems of NFIP: the oversight and management deficiencies, the inaccuracy of many of the flood maps, the poor record of the flood plain management, and the failure of the Write Your Own companies to honor their fiduciary responsibility to the federal government. The main source of all of these problems is that the NFIP and FEMA have proven the textbook case of just how inefficient a program can be if it is handed over to the contractors, vendors, and insurance companies who have conflicts of interest yet are allowed to obligate federal tax dollars with little federal government oversight.

I urge Congress to pass the Multiple Peril Insurance Act and when it passes I urge FEMA and NFIP to hire qualified, professional federal employees who will be accountable to the taxpayers to setup and manage the program. Please do not run it in the same manner as the current flood program.