



Highlights of [GAO-10-1063T](#), a testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

Why GAO Did This Study

The National Flood Insurance Program (NFIP), established in 1968, provides policyholders with insurance coverage for flood damage. The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security is responsible for managing NFIP. Unprecedented losses from the 2005 hurricane season and NFIP's periodic need to borrow from the U.S. Treasury to pay flood insurance claims have raised concerns about the program's long-term financial solvency. Because of these concerns and NFIP's operational issues, NFIP has been on GAO's high-risk list since March 2006. As of August 2010, NFIP's debt to Treasury stood at \$18.8 billion. This testimony discusses (1) NFIP's financial challenges, (2) FEMA's operational and management challenges, and (3) actions needed to address these challenges. In preparing this statement, GAO relied on its past work on NFIP and GAO's ongoing review of FEMA's management of NFIP, particularly data management and contractor oversight issues.

What GAO Recommends

In past work, GAO recommended, among other things, that FEMA take steps to help ensure that premium rates are more reflective of flood risks; strengthen its oversight of NFIP and insurance companies responsible for selling and servicing flood policies; and strengthen its internal controls and data quality. FEMA has begun to take steps to address some of these recommendations.

View [GAO-10-1063T](#) or [key components](#). For more information, contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov.

NATIONAL FLOOD INSURANCE PROGRAM

Continued Actions Needed to Address Financial and Operational Issues

What GAO Found

While Congress and FEMA intended that NFIP be funded with premiums collected from policyholders rather than with tax dollars, the program is, by design, not actuarially sound. NFIP cannot do some of the things that private insurers do to manage their risks. For example, NFIP is not structured to build a capital surplus, is likely unable to purchase reinsurance to cover catastrophic losses, cannot reject high-risk applicants, and is subject to statutory limits on rate increases. In addition, its premium rates do not reflect actual flood risk. For example, nearly one in four property owners pay subsidized rates, "full-risk" rates may not reflect the full risk of flooding, and NFIP allows "grandfathered" rates that allow some property owners to continue paying rates that do not reflect reassessments of their properties' flood risk. Further, NFIP cannot deny insurance on the basis of frequent losses and thus provides policies for repetitive loss properties, which represent only 1 percent of policies but account for 25 to 30 percent of claims. NFIP's financial condition has improved slightly due to an increase in the number of policyholders and moderate flood losses, and since March 2009, FEMA has taken some encouraging steps toward improving its financial position, including making \$600 million in payments to Treasury without increasing its borrowings. However, it is unlikely to pay off its full \$18.8 billion debt, especially if it faces catastrophic loss years.

Operational and management issues may also limit efforts to address NFIP's financial challenges and meet program goals. Payments to write-your-own (WYO) insurers, which are key to NFIP operations, represent one-third to two-thirds of the premiums collected. But FEMA does not systematically consider actual flood insurance expense information when calculating these payments and has not aligned its WYO bonus structure with NFIP goals or implemented all of its financial controls for the WYO program. GAO also found that FEMA did not consistently follow its procedures for monitoring non-WYO contractors or coordinate contract monitoring responsibilities among departments on some contracts. Some contract monitoring records were missing, and no system was in place that would allow departments to share information on contractor deficiencies. In ongoing GAO work examining FEMA's management of NFIP, some similar issues are emerging. For example, FEMA does not have an effective system to manage flood insurance policy and claims data, although investing roughly 7 years and \$40 million on a new system whose development has been halted. However, FEMA has begun to acknowledge its management challenges and develop a plan of action.

Addressing the financial challenges facing NFIP would likely require actions by both FEMA and Congress that involve trade-offs, and the challenges could be difficult to remedy. For example, reducing subsidies could increase collected premiums but reduce program participation. At the same time, FEMA must address its operational and management issues. GAO has recommended a number of actions that FEMA could take to improve NFIP operations, and ongoing work will likely identify additional issues.