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Testimony

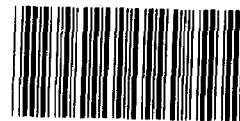
Before the Subcommittee on Housing and Urban Affairs,  
Committee on Banking, Housing and Urban Affairs  
United States Senate

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Flood Insurance

Information on Various  
Aspects of The National Flood  
Insurance Program

Statement of Judy A. England-Joseph, Director,  
Housing and Community Development Issues,  
Resources, Community, and Economic Development Division



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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the preliminary results of our ongoing reviews of the National Flood Insurance Program (NFIP) as you consider S.1405, the National Flood Insurance Reform Act of 1993. This work was requested by the former Chairman of the Subcommittee; the Chairman of the Senate Committee on Banking, Housing and Urban Affairs; and Senator John Kerry. As you know, NFIP is administered by the Federal Emergency Management Agency's (FEMA) Federal Insurance Administration (FIA).

The December 1992 nor'easter, the March 1993 storm in Florida, and the midwest flooding this summer have almost drained the NFIP fund. This has raised concerns by some members of the Congress and the public about whether the NFIP whose purposes include reducing federal expenditures on disaster assistance has sufficient financial resources to meet its current obligations and potential future payments resulting from flood damage claims made by property owners insured under the program.

Among other things, we were asked to review the (1) actuarial soundness of the NFIP fund and the implication of eliminating its subsidized flood insurance rates, (2) procedures used to set the program's flood insurance rates, and (3) financial management problems addressed in FEMA's Office of Inspector General (OIG) audits of the fund.

In summary, the NFIP fund is not, nor is it required to be, actuarially sound. This means that the NFIP fund may not have sufficient financial resources to meet future estimated losses. The fund is not actuarially sound primarily because Congress authorized insurance rates charged many policyholders to be subsidized without providing annual appropriations to fund the subsidy.

Modifying the fund to be actuarially sound by requiring subsidized property owners to pay actuarial rates may not minimize the federal government's overall expenditures on flood-related disaster relief. The significant rate increase that would result for subsidized property owners if this change were made would likely lead some of them to cancel their flood insurance. If policyholders with subsidized rates cancel their insurance policies, the federal government would likely face increased costs in the form of other federal disaster relief assistance such as FEMA disaster assistance grants. Whether the increased costs that would be incurred by other federal disaster relief programs would be less than, or more than, the current subsidy cannot be estimated because the number of policyholders that would cancel their insurance is unknown.

Currently, 59 percent of the 2.5 million NFIP policyholders are charged actuarial rates based on actual risk exposures and

risk-related features, such as the flood-risk zone. However, for 41 percent of the policyholders in areas of high flood risk, FIA sets the subsidized rates based on the revenue needed to at least match the difference between NFIP's average historical loss year and the revenue expected from its policies with actuarial rates. Subsidized policyholders currently pay greater premiums than policyholders paying actuarial rates, but average premiums would have to approximately triple to about \$1,100 if FIA computed these rates on an actuarial basis. If all 2.5 million policies had paid actuarial rates in fiscal year 1991, the fund would have received about \$780 million more in premium income that year, or more than double the premium income actually collected. While FEMA only estimated the dollar value of the subsidy for this one year, the fund would currently have a significant reserve if rates had never been subsidized and participation in the program had not been effected by higher rates.

Because of recent losses sustained by the fund, it may not have sufficient financial resources to meet future estimated losses, and FIA may have to exercise its borrowing authority to pay claims. However, FEMA's OIG identified serious problems in NFIP's financial management including the fact that the NFIP's fund balance on deposit in the U.S. Treasury is commingled with all other FEMA funds into one balance and FIA has not reconciled its records with reported U.S. Treasury funds for many years. FIA has not implemented the OIG recommendation to establish a separate account, but it has acknowledged inaccuracies with the fund balance and is working to resolve the problem. Therefore, FIA's determination of when, and if, the fund needs to borrow may not be based on adequate data on the amount of funds on deposit with the U.S. Treasury. Because the financial condition of the fund has deteriorated, we believe that FIA should implement the OIG recommendation to establish a separate NFIP account in the U.S. Treasury.

Mr. Chairman, we were also requested to review two other issues (1) lender compliance with the mandatory insurance purchase requirement and (2) efforts made under the program to mitigate future flood damage. We have performed some work on lender compliance, but have only recently begun work on mitigation. Our review to date of the flood victims of the December 1992 nor'easter who received FEMA grants is finding similar results to those we reported in a 1990 report<sup>1</sup>-- the majority of the recipients of FEMA grants that did not have flood insurance were not required to have insurance. My testimony outlines the work we plan to undertake to carry out these two objectives and the results of our work on lender compliance to date.

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<sup>1</sup>Information on the Mandatory Purchase Requirement (GAO/RCED-90-141FS, Aug. 22, 1990).

Before I discuss our ongoing reviews of NFIP in detail, let me briefly outline the purpose of NFIP, the history of its financial condition, and who is required to purchase flood insurance.

## BACKGROUND

The National Flood Insurance Act of 1968 (P.L. 90-448), as amended, established NFIP to make flood insurance available to property owners, mitigate flood hazards, and reduce total federal expenditures on disaster assistance. Prior to the act, flood insurance was generally not available from private insurance companies.

The act requires that premiums paid by property owners be placed in a fund for use in paying claims. In addition, the Congress authorized FIA to borrow up to \$1 billion from the U.S. Treasury for those instances when claims paid were more than the fund's balance. Since the inception of the program through fiscal year 1986, the Congress appropriated about \$2.1 billion, which represents about \$3.3 billion in constant 1992 dollars, to NFIP to repay past loans from the U.S. Treasury and to pay for administrative expenses. No appropriations have been made to NFIP since fiscal year 1986.

Since the inception of NFIP, flood insurance rate maps (FIRM) have been prepared by FIA for over 20,000 flood prone communities to define different areas of flooding risk. Each of these FIRMs includes any special flood hazard areas--also known as 100-year floodplains--which are defined as areas subject to a 1-percent or greater chance of experiencing flooding in a given year. Only residents of communities that joined NFIP are eligible to purchase flood insurance--about 85 percent of the flood prone communities have entered NFIP. Most of the communities that did not join NFIP had no development in their floodplain.

As a prerequisite to joining NFIP, the community had to adopt FIA approved floodplain management strategies, and FIA established building standards designed to reduce flood damage. Structures built after the community's FIRM was prepared (known as post-FIRM structures) are generally more flood worthy and are charged actuarial or risk-related rates that are not subsidized. To encourage widespread purchase of flood insurance by owners of structures built before the FIRM was prepared (pre-FIRM structures), the Congress authorized FIA to make subsidized rates available.

From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance was voluntary. The 1973 act required the mandatory purchase of flood insurance after March 1, 1974, for (1) any federal loan or grant to be used for acquisition or construction of a building or a mobile home in a designated flood hazard area of a participating community and (2) a

loan secured by improved property in a special flood hazard area of a participating community if the loan is made by a lending institution that is regulated or insured by the federal government. Such lending institutions are responsible for ensuring that flood insurance is purchased in these instances. For loans made before March 1, 1974, flood insurance is not required. Also, homes with no mortgage, or homes with mortgages held by unregulated lenders are exempt.

In addition to NFIP, assistance from two other federal disaster relief programs can be made available to assist individuals who are victims of floods. The Small Business Administration (SBA) offers low-interest loans to flood victims who are creditworthy. SBA requires that the recipient of such a loan living in the 100-year floodplain must purchase and maintain flood insurance for the life of the loan. A flood victim who cannot obtain an SBA loan may apply for a FEMA individual and family grant of up to \$11,900 or the amount of the loss, whichever is less. As a prerequisite of receiving the grant, the property owner is required to purchase and maintain flood insurance for 3 years.

The stated purposes of S.1405 is to strengthen the NFIP by reducing risks to the NFIP fund through increased compliance, incentives for community floodplain management, and mitigation assistance.

#### ACTUARIAL SOUNDNESS OF THE NATIONAL FLOOD INSURANCE FUND

The NFIP fund is not actuarially sound. The Congress, by authorizing subsidized rates for pre-FIRM structures without providing annual appropriations to fund the subsidy, did not set up the fund to be actuarially sound. At the same time, the Congress required rates on post-FIRM structures to be set at risk-related rates. As of 1993, rates for about 41 percent of the 2.5 million flood insurance policies are subsidized and average only about one-third of what the actuarial rate for those policies would be. The latest available information shows that if all 2.5 million policies had paid actuarial rates in fiscal year 1991, the fund would have received about \$780 million more in premium income that year, or more than double the premium income actually collected. While FEMA only estimated the dollar value of the subsidy for this one year, the fund would currently have a significant reserve if rates had never been subsidized and participation in the program had not been effected by higher rates.

In the 1980s, FIA developed a goal for NFIP to collect sufficient revenues each year to at least meet the expected losses of an average historical loss year based on experience under the program since 1978. Because the NFIP has not suffered any catastrophic loss years since 1978, the average historical loss year used by FIA involves less claims loss than the average expected per annum claims loss over the long run. Thus, premium

income does not reflect collections necessary to build reserves for potential catastrophic years in the future.

Since fiscal year 1987, FIA's goal of basing premium income on the historical average loss year, which is estimated to be between \$375 million to \$400 million as of 1993, has allowed the fund to cover insurance claims as well as program and administrative expenses without borrowing from the U.S. Treasury. However, the fund may not be able to cover all claims and expenses in fiscal year 1993 which amounted to about \$765 million by the beginning of September 1993, primarily due to the December 1992 nor'easter, the March 1993 flooding in western Florida, and the July 1993 midwest flooding. Thus far, FIA officials expect about 5,000 to 10,000 claims amounting to between \$50 million and \$100 million from the July 1993 midwest flooding. FIA does not yet know what impact Hurricane Emily will have on the flood insurance fund, but as of early September 1993, FIA projects that Emily will generate about 2,000 claims. According to FIA officials, as of August 1993, NFIP's obligations were about \$35 million more than its assets. Whether, in fact, FIA will have to exercise its borrowing authority will depend on (1) the relative timing of payments on its current obligations and monthly premium receipts of about \$55 million and (2) the amount of future insurance claims.

Modifying the fund to be actuarially sound by requiring owners of pre-FIRM structures to pay actuarial rates may not minimize the federal government's expenditures on flood-related disaster relief. If the subsidy on pre-FIRM structures were phased out, insurance rates would need to rise approximately threefold, implying an annual average premium of about \$1,100 for these structures. Such a significant rate increase would likely lead some pre-FIRM property owners, although we do not know how many, to cancel their flood insurance. If owners of pre-FIRM structures, which suffer the greatest flood loss, cancelled their insurance policies, the federal government would likely face increased costs in the form of FEMA disaster assistance grants and SBA low-interest loans in future floods. Although the information is dated, Mr. Chairman, it is interesting to note that in the early 1980s, our analysis indicated that if NFIP doubled the then existing average premiums (both subsidized and actuarial) about 40 percent of the homeowners would cancel their policies.<sup>2</sup>

The effect on total federal disaster assistance costs of phasing out subsidized rates cannot be estimated because the number of current NFIP policyholders that would cancel their policies is unknown. Thus, it is not possible to estimate if the increased

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<sup>2</sup>National Flood Insurance Program: Major Changes Needed If It Is To Operate Without A Federal Subsidy, (GAO/RCED-83-53, Jan. 3, 1983).

costs of other federal disaster relief programs would be less than, or more than, the current NFIP subsidy cost.

We noticed, Mr. Chairman, that S.1405 contains provisions to study the NFIP's premium structure. It would set up an interagency task force, including representatives from FEMA; Departments of Housing and Urban Development, Veterans Affairs, and Agriculture; and SBA to, among other things, study the possibility of revising the rate structure to account for catastrophic events and to propose strategies to establish an actuarial-based premium structure to account for all insurable risks.

Because of the complexities of the NFIP and the potential impact changes to this program have on other disaster assistance programs, we believe that the establishment of such a task force is a necessary step in proposing revisions and strategies to establish an actuarial-based premium structure.

#### ACTUARIAL AND SUBSIDIZED RATE SETTING

As I mentioned previously, Mr. Chairman, NFIP flood insurance premiums are either based on actuarial principles or are subsidized depending on when the structure was built. FIA's method for establishing actuarial rates for post-FIRM construction lying within the identified 100-year floodplain follows a hydrologic method based on studies performed by the U.S. Army Corps of Engineers and private engineering companies.<sup>3</sup> These rates are based on available hydrologic data, flood insurance claims, simulations, as well as engineering and actuarial judgment. The basic elements needed to predict expected flood loss include probability estimates of the frequency with which floods of different severity will occur, and estimates of associated structural property damage incurred due to different types of floods. Actuarial rates are based on actual risk exposures and generally vary according to several risk-related features, such as the flood-risk zone, the height of the structure, and the amount of insurance purchased.

Subsidized rates are available only on the first \$35,000 of insurance coverage for pre-FIRM properties with actuarially-based rates for any additional insurance coverage. They have never been set through an analysis of underlying flood risk on these properties. Instead they are set through a rule making and legislative process. In order to set rates on subsidized policies, FIA first determines the revenue needed to meet an average historical loss year based on its current policies in-force and its expected loss and nonloss-related costs. Next, FIA determines the revenue it will receive from policies with actuarially based rates. FIA then subtracts the expected revenue from actuarially based

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<sup>3</sup>We have not reviewed these studies.



policies from the average historical loss year to determine the minimum premium income needed from policies with subsidized rates. FIA then computes the subsidized rate based on the minimum revenue needed and the number of subsidized policies. The proposed subsidized rate is published in the Federal Register for public comment and subsequently submitted for congressional approval as part of FIA's budget and authorization proceeding.

According to FIA documents, the average premium on an actuarial policy will be \$247 in 1994. The average premium on a subsidized policy for 1994 will be \$401 if the Congress approves a 5 cent increase in the subsidized rate. Premiums for subsidized policies are higher than those for actuarial structures but are only about one-third of what they would need to be for these rates to fully reflect flooding risks on pre-FIRM construction. FIA officials told us that pre-FIRM structures are not as elevated as post-FIRM structures and, thus, on average, are 4-1/2 times more likely to suffer a loss. When pre-FIRM structures suffer a loss, the damage sustained is about one-third more than for post-FIRM structures. According to FIA, when these two factors are combined, pre-FIRM structures on average suffer about 6 times the damage of post-FIRM structures. The higher elevation standard is one of the primary building standards that FIA requires communities to adopt as a prerequisite for joining NFIP.

The previously mentioned interagency task force that would be created if S.1405 became law, Mr. Chairman, will also study the extent to which the flood insurance premium rate structure could be revised to minimize existing premium rate subsidies and to incorporate premium rate adjustments for erosion hazards.

#### NFIP's FINANCIAL MANAGEMENT SYSTEM

Because of recent losses sustained by the fund, it may not have sufficient financial resources to meet future estimated losses, and FIA may have to exercise its borrowing authority to pay claims. However, two audits of FIA's financial statements for fiscal years 1991 and 1992 made in accordance with the Chief Financial Officer's Act identified serious problems in NFIP's financial management affecting the fund's balance on deposit in the U.S. Treasury. Furthermore, FEMA's Inspector General found problems in other NFIP financial management systems.

FEMA's Inspector General reported that FIA does not have systems or records to effectively track or monitor NFIP's fund balance with the U.S. Treasury. Furthermore, the audits found serious problems with NFIP's financial management system and internal control structure that prevent the accumulation and reporting of reliable financial information. Since 1979, FEMA has acknowledged that its financial management procedures and practices have been both limited and inconsistently implemented. Also, the Office of Management and Budget has listed both FEMA's internal

control structure and its financial management systems as high-risk areas.

NFIP's cash balance with the Treasury along with investments represent the resources available to pay flood claims and the program's administrative costs. FEMA's Inspector General reported that NFIP's balance with the Treasury is commingled with all other FEMA funds into one balance and FIA has not reconciled its records with reported U.S. Treasury funds for many years. Therefore, FIA cannot verify that the NFIP balance it maintains is accurate according to the Inspector General.

FEMA's Inspector General recommended that FEMA establish a separate account for the NFIP fund in the U.S. Treasury. FIA officials have not implemented the Inspector General's recommendation to establish a separate account, but acknowledged inaccuracies with the fund balance and said that they are working at resolving the problems.

FEMA's Inspector General also reported that it was unable to express an opinion on NFIP's financial statements for fiscal years 1991 and 1992. Specifically, the OIG reviews found that (1) property and equipment accountability was inadequate, (2) inventories were not accounted for, and (3) administrative expenses were not accurately reported. The Inspector General recommended various short-term actions to correct these problems, such as conducting physical inventories of NFIP's assets and reporting administrative expenses on an accrual basis. FIA has not implemented either of these actions, but instead is relying on the implementation of FEMA's Five-Year Financial Plan for fiscal years 1992-96 to provide long-term solutions to NFIP's financial management problems.

Because the current obligations of the fund exceed its present balance, we believe that FIA should implement the OIG's recommendation to establish a separate NFIP balance in the U.S. Treasury. Also, we believe that FIA should reexamine its decision not to make short-term improvements in NFIP's financial management system.

#### LENDER COMPLIANCE WITH THE MANDATORY INSURANCE PURCHASE REQUIREMENT

Mr. Chairman, in 1990 we issued a report on lender compliance with the mandatory insurance purchase requirement involving two floods in the states of Texas and Maine. In 1992, we testified before this Subcommittee on the results of our review. Specifically, we found that a large majority of the flood victims in the two states that received disaster assistance--78 percent--were not subject to the mandatory purchase requirement, either because households had unmortgaged property or mortgages were held by unregulated lenders. We also found that most disaster-assisted households in Maine subject to the mandatory purchase requirement

had flood insurance; however, most in Texas did not. We could not identify the reason for the disparity between the two states.

Reasons cited by lending institutions in both Texas and Maine varied as to why the properties that should have been insured were not. The most frequently cited reasons were the lender (1) erroneously classified the property as not being in an area for which insurance was mandatory or the property was not classified at all, (2) neglected to require the flood insurance at loan closing even though the lender identified the property as in an area for which insurance was mandatory, and (3) required the flood insurance at the time the loan was made but later allowed the policyholder to drop the insurance without taking any action.

Our current work on lender compliance with the mandatory insurance purchase requirement focuses on flooding caused by the December 1992 nor'easter in New York and New Jersey. FEMA had estimated that it would receive NFIP claims amounting to about \$243 million shortly after this storm which was greater than the NFIP's combined losses for Hurricanes Andrew and Iniki.

Nearly two-thirds of the federally associated assistance applied for by flood victims in the two states was for individuals covered under the NFIP as shown in table 1 below. In recent years, premium income received from policyholders paying actuarial rates has exceeded the policyholders' claims. Therefore, the NFIP had funds available to pay the claims from the 1992 nor'easter without borrowing from the U.S. Treasury. About one-third of the federal assistance was for flood victims, most of whom were not insured under the NFIP, who applied for either Treasury-subsidized low-interest disaster loans from SBA or grants from FEMA.

Table 1: Analysis of Federally Associated Assistance in New York and New Jersey for Which Application Was Made by Flood Victims of the December Nor'easter

<u>Assistance</u>	<u>Number</u>	<u>Dollars (in millions)</u>	<u>Percentage of dollars</u>
NFIP claims	24,448	\$245.9	65
SBA loans	4,874	118.9	32
FEMA grants	3,758	11.6	3
Total		\$376.4	100

We are currently examining the databases for SBA loans and for FEMA individual and family grants made in New York and New Jersey to determine whether recipients of these loans and grants lived in a special flood hazard area, had flood insurance, and, if not, why not. While we have not yet begun work on SBA loans, our preliminary work on recipients of FEMA grants indicates that many of them were not required to comply with the mandatory insurance purchase requirement because they had no mortgage or had a mortgage

with an unregulated lender. However, we are also finding some recipients that should have had insurance but did not.

FEMA attempted to obtain the names of lenders, if any, for those recipients of its grants that lived in special flood hazard areas in New York and New Jersey. Of the 1,403 homeowners who received grants and live in special flood hazard areas, FEMA identified 125 homeowners who also had flood insurance--we have not yet determined why homeowners with insurance also received a grant. As a result, there were 1,278 homeowners who received grants in special flood hazard areas that did not have flood insurance. However, FEMA was not able to obtain mortgage information on 526 of these homeowners. The results of our analysis of the remaining 752 homeowners that did not have flood insurance for which mortgage information is available is presented below.

--232 homeowners, or 31 percent, should have had insurance, and

--520 homeowners, or 69 percent, were not required to have insurance because (1) 491 homeowners, or 94 percent, did not have a mortgage and (2) 29 homeowners, or 6 percent, had mortgages with unregulated lenders.

In addition, Mr. Chairman, we have begun to obtain reasons why the 232 homeowners did not have the required insurance. At this point, we have information for just a few of these homeowners which indicates that the lenders (1) made erroneous flood determination prior to loan closing and (2) did not enforce flood insurance policy renewals. Also, federal bank regulatory agencies, such as the Federal Deposit Insurance Corporation, told us that, when conducting compliance examinations, examiners review loan files for compliance with many regulations of which flood insurance is one. With the problems facing the banking industry over the past few years, the agencies told us that their examiners have had to spend additional time looking at the safety and soundness of the bank and less time looking at flood insurance and other compliance items.

In the next few months, we intend to complete our efforts on lender compliance. We will continue to examine SBA's and FEMA's data bases and contact lenders and homeowners to determine reasons why the required insurance was not purchased or renewed.

S.1405 contains provisions to increase the rate of compliance with the mandatory insurance purchase requirement. It notes that the low percentage of homeowners having flood insurance in a special flood hazard area is not caused solely, or even primarily, by a lack of compliance by those that must purchase insurance but is also caused to a large extent by a lack of coverage among those that are not required to purchase such insurance. The bill proposes steps to (1) strengthen the purchase requirement for federal agencies that support home loans and the Federal National Mortgage Association and the Federal Home Loan Mortgage

Corporation; (2) require premiums to be escrowed if possible; (3) force place, or buy the flood insurance for the property owner, if the owner does not; and (4) fine lenders for not complying.

Mr. Chairman, I would like to make two points regarding S.1405's provisions aimed at increasing the rate of compliance with the mandatory insurance purchase requirement. Increased participation by subsidized and unsubsidized property owners in NFIP is likely to reduce the cost of other federal disaster assistance programs--FEMA grants and SBA loans. However, increased participation by subsidized property owners will increase the potential liability of the NFIP because the premiums received from subsidized policyholders will not be sufficient to meet future estimated losses on these policies.

#### NFIP'S ATTEMPTS TO MITIGATE FUTURE FLOOD DAMAGE

Our work to date has not yet focused on NFIP's efforts to mitigate flood damage; however, we would like to point out three areas that we will be reviewing. Specifically, (1) the impact of FIA-established building standards used in special flood hazard areas, (2) FIA's efforts to deal with repetitive losses, and (3) FIA's efforts to assist state and local governments, such as the section 1362 program which authorizes funds to purchase both flood-prone structures and their lots on a willing-seller basis.

Building standards. One of the primary building standards a community must adopt to be eligible to join NFIP is to elevate structures within the identified 100-year floodplain to at least a level at which there is no greater than a 1-percent risk that it will be flooded in a given year. Pre-FIRM structures not built to these standards, on average, suffer 6 times the flood damage of post-FIRM structures. However, pre-FIRM structures that incur damage of over 50 percent of the structure must be rebuilt according to NFIP building standards. But, elevating such structures could cost \$30,000 or more, a cost that is borne by the homeowner. The high cost of such a procedure is causing some homeowners to consider not rebuilding structures destroyed by Hurricane Andrew. This may also be a problem for some homeowners affected by the recent midwest flooding.

Repetitive loss structures. Under the current NFIP operational definition, a repetitive loss structure is defined as a structure that has received two or more flood insurance claim payments of at least \$1,000 since 1978. According to FIA, about 50,500 structures fit this definition--about 2 percent of the NFIP's policies--but these structures account for 52 percent of the claims paid and 47 percent of the dollars paid out of the fund. An owner of a structure that has suffered repetitive losses of less than 50 percent in the past does not have to (1) take measures to improve the floodworthiness of the structure or (2) pay higher insurance rates.

Section 1362 program. Officials of various state and national organizations representing state floodplain and emergency management interests, told us that more resources are needed for flood mitigation programs. The section 1362 program is designed to reduce flood damage through the purchase and removal of buildings that have been severely damaged, or damaged more than 25 percent three times in a five year period.

We notice, Mr. Chairman, that S.1405 highlights the need for NFIP to improve its mitigation efforts and authorizes the expenditure of additional funds for flood and erosion mitigation assistance activities. The bill would also allow FIA to charge the applicable risk premium rate based on accepted actuarial principles to a property determined to be a repetitive loss structure.

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In conclusion, Mr. Chairman, requiring subsidized policyholders to pay actuarial rates would be a primary way to make the NFIP fund actuarially sound, but in doing so could (1) cause a significant number of these policyholders to cancel their insurance and (2) increase the costs of other federal disaster relief assistance grant and loan programs. Whether the increased costs that would be incurred by other federal disaster assistance programs would be less than, or more than, the current subsidy cost cannot be estimated because the number of policyholders that would cancel their insurance is unknown. Therefore, there is a need for the task force that would be established by S.1405 in studying revisions to premium rate structures and strategies, to establish an actuarially based premium structure to not only examine such revisions in the context of their impact on NFIP, but to also consider their potential impact on other federal disaster assistance programs.

Also, FIA's determination of when, and if, the NFIP fund needs to borrow from the U.S. Treasury may not be based on adequate data that FEMA's maintains on the amount of NFIP funds it has on deposit in the U.S. Treasury. FEMA's Inspector General has raised serious questions about FIA's system to track the fund's balance at the U.S. Treasury and the adequacy of its financial management and internal control structure. Because FIA may have to exercise its borrowing authority to pay claims, we believe that FIA should implement the OIG's recommendation to establish a separate NFIP balance in the U.S. Treasury. Also, we believe that FIA should reexamine its decision not to make short-term improvements in NFIP's financial management system.

Our limited work to date does not allow us to make firm conclusions about lender compliance; however, our work on the 1992 nor'easter does indicate most property owners in special flood hazard areas in New York and New Jersey that do not have flood insurance are not required to have insurance.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or the other members may have.

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