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NATIONAL FLOOD INSURANCE PROGRAM: ISSUES EXPOSED BY THE 2005 HURRICANES

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

AND THE

SUBCOMMITTEE ON MANAGEMENT,
INVESTIGATIONS, AND OVERSIGHT

OF THE

COMMITTEE ON HOMELAND SECURITY

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NATIONAL FLOOD INSURANCE PROGRAM: ISSUES EXPOSED BY THE 2005 HURRICANES

Tuesday, June 12, 2007

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
AND SUBCOMMITTE ON MANAGEMENT,
INVESTIGATIONS, AND OVERSIGHT,
COMMITTEE ON HOMELAND SECURITY,
Washington, D.C.

The subcommittees met, pursuant to notice, at 3:11 p.m., in room 2128, Rayburn House Office Building, Hon. Melvin Watt [chairman of the Subcommittee on Oversight & Investigations] presiding.

Present from the Subcommittee on Oversight & Investigations: Representatives Watt, Klein, Wexler; Miller and Bachus [ex officio].

From the Subcommittee on Management, Investigations, and Oversight: Representatives Carney, Clarke, Perlmutter; and Rogers.

Also present: Representatives Taylor, Scott, and Jindal.

Chairman WATT. This joint hearing of the Committee on Financial Services Oversight and Investigations Subcommittee and the Committee on Homeland Security Management, Investigations, and Oversight Subcommittee will come to order.

I will recognize myself for a brief opening statement. I apologize to everyone who has been so patiently waiting for us, but we were called for a series of votes, and got sidetracked in our schedule, so we'll try to move along quickly.

I recognize myself for a 5-minute opening statement, or less.

It has been nearly 2 years since the devastation of Hurricanes Katrina and Rita. Gulf Coast residents are still trying to rebuild their homes, their lives, and their businesses. A potential roadblock to this recovery is the ongoing conflict over the insurance claims process in the Gulf Coast.

This is the second in a series of hearings the Financial Services Subcommittee on Oversight and Investigations has held on the issue of insurance practices in the Gulf Coast in the wake of Katrina and Rita.

The first hearing explored the overall insurance claims payment process in the Gulf Coast after the 2005 hurricanes. We heard testimony from FEMA representatives, the Mississippi attorney general, industry experts, and several Gulf Coast representatives who have been personally affected by the tragedy.

Much of the controversy in the aftermath of the 2005 hurricanes has focused on the insurance claims payment process and the allegation that hurricane victims have not received adequate compensation because damage caused by wind, which is supposed to be paid by private insurers under homeowners policies have been improperly classified as flood damage and paid by the National Flood Insurance Program (NFIP).

This question has spawned numerous lawsuits and at least one grand jury investigation.

Rehashing the merits of the individual lawsuits is not our purpose today. Today, we move the debate forward by seeking to shed light on the actual data concerning flood and wind claims as a result of Katrina and Rita, including possible data limitations that may have hampered FEMA in its ability to provide proper oversight of the National Flood Insurance Program.

We are pleased to have two Government witnesses, one from the Department of Homeland Security Inspector General's Office, and the other from the Government Accountability Office, or GAO, both of whom have been investigating the related issues of the availability and quality of data concerning flood and wind claims and FEMA's oversight of the National Flood Insurance Program.

These investigations and evaluations have been done pursuant to two different requests, which I'm going to put in the record.

One, the GAO study, I believe, was initiated at the request of the former chairman of the Financial Services Committee, Mike Oxley, in a letter dated January 24, 2006, and joined in by the current chairman of the Financial Services Committee, Representative Barney Frank.

The second investigation was initiated pursuant to an appropriations bill which directed that the Inspector General investigate whether and to what extent in adjusting and settling claims resulting from Hurricane Katrina, insurers making flood insurance coverage available under the Write-Your-Own program pursuant to 1345 of the National Flood Insurance Act improperly attributed damages from such hurricane to flooding.

I will ask unanimous consent to submit former Chairman Oxley's letter and the language which authorized the Inspector General study for the record.

Without objection, it is so ordered.

Both of these Agencies are preparing reports on these issues which should be released this year or early next year.

Today, they will offer preliminary findings from these reports. We hope that their testimony will help provide transparency and accountability regarding the operation of the National Flood Insurance Program and the overall insurance claims payment process in the Gulf so that taxpayers, Gulf Coast residents, and the Members of Congress can have confidence that the National Flood Insurance Program and the private insurance market are each living up to their responsibility and that catastrophe victims are treated fairly.

I now recognize the ranking member of the Financial Services Oversight Subcommittee, Mr. Gary Miller, for his opening statement.

Mr. MILLER. Thank you, Mr. Chairman.

I would like to ask unanimous consent that members of the full Committee on Financial Services and the Committee on Homeland Security be allowed to make opening statements at today's subcommittee hearing to the extent that they are allotted time.

With that, I grant myself 5 minutes.

I thank the chairman for holding this hearing, and I'd like to welcome the Homeland Security Subcommittee on Management and Investigation here today, and also the witnesses; we are glad you are here with us.

There is no question that the 2005 hurricane season resulted in significant strain to the NFIP. The claims resulting from the losses from the catastrophic hurricanes are unprecedented in the history of the program.

Obviously, with almost $18 billion in flood claims being paid by the Treasury rather than the flood program itself, we must ensure that taxpayers are not footing the bill for inappropriate claim adjustments.

Some have alleged that insurers shifted wind claims to the flood program so they could pay less for the wind portion of the hurricane loss. If this is true, it is an outrage that should be rectified immediately, and those engaged in such fraud should be strongly punished.

Particularly in cases of property damage by both flooding and wind, strong oversight must be in place for the National Flood Insurance Program to ensure that it does not pay out more than it should.

This is a difficult prospect. Flood and wind damage are supposed to be assessed separately, but in some cases they occur simultaneously.

At our first hearing on this subject, we heard from the Mitigation Division Director and Federal Insurance Administrator for the Federal Emergency Management Agency, David Maurstad, who testified that the NFIP only paid for damage associated with flood and only up to the covered limits.

According to Mr. Maurstad, there is a rigorous program of oversight in place to ensure that the NFIP only pays for damage caused by flooding. Mr. Maurstad testified that no claims from the 2005 hurricanes have come to his attention that should not have been paid at the levels they were paid.

I look forward to hearing from the witnesses today who have been given the difficult task of assessing whether FEMA has taken adequate steps to ensure that the NFIP's flood claim payments are accurate and appropriate.

As I said previously, this subcommittee was assured by FEMA at the last hearing that controls are in place to assure that the NFIP does not pay out more than is required under the terms of the flood policy.

Today, we have the opportunity to hear the opinions of independent sources about whether they agree with FEMA's assessment about its oversight process and its ability to ensure the accurate payment of claims.

If the NFIP paid more than it should have after the 2005 hurricanes because insurance companies pushed wind losses to the flood

program rather than paying for them under homeowners policies, then we must hold them accountable for their actions.

But let me just say that there is a difference between the potential of wrongdoing and the finding of actual wrongdoing. This is an important distinction as we proceed today.

I have reviewed the written statements of the witnesses today and I understand that misbehavior on the part of the insurance companies that write both flood and wind policies for the customers cannot be ruled out at this point in time of the investigation; they just haven't completed the reviews yet. Let us not prejudge the findings of these important investigations, or vilify the entire insurance industry for claim shifting, without concrete evidence to prove such allegations of widespread wrongdoing occurred.

In conclusion, I think we need to proceed cautiously today. We have all seen the anecdotal news reports and heard stories of our colleagues from the region about practices by some insurance companies that, if true, are very disturbing and must be addressed.

I am also aware of examples of companies that use two separate adjusters for handling wind claims and water claims to avoid the potential for conflict, as has been alleged. Such adjusters have been kept separate. They did not communicate with one another, and they utilized completely different claim systems.

Did insurance companies abuse the NFIP to protect their bottom lines? Was such abuse widespread? At this point we do not have the evidence to make a determination either way. We just don't know, and we need to allow the GAO and DHS IG to complete their important work before rushing to judgment.

We need to take the preliminary findings of these reports at face value and for the purpose of moving forward with the NFIP's reform legislation.

We should use this hearing to ask important questions about ways to avoid the potential for abuse in the future. For example, we should consider how we ensure that Write-Your-Own, WYO, insurance companies do not have the ability to defraud the NFIP when the structure endures wind and flood damage?

Is it best to require more coordination between flood and wind damages or is it best to require absolute separation between the claims, including requiring different claims adjusters?

Should the existing NFIP claims adjustment procedure be revisited to ensure any potential conflicts of interest are eliminated?

Once the GAO and DHS IG complete their important studies, we will have a better sense of whether and to what extent damages from the 2005 hurricanes were improperly attributed to flood rather than wind.

With that, I yield back.

Chairman WATT. I thank the gentleman.

I'm pleased to yield 5 minutes to the chairman of the Homeland Security Management, Investigations, and Oversight Subcommittee, Mr. Carney, from Pennsylvania.

Mr. CARNEY. Thank you, Mr. Chairman.

I'd like to thank Chairman Frank, of course, and you, Chairman Watt, for holding this joint hearing with my subcommittee regarding the NFIP.

In the wake of any catastrophe, whether a natural disaster or a terrorist attack, government and the private sector have to do their part for the country to recover. If either fails to fulfill its responsibilities, recovery will at best be delayed and at worst be impossible.

Nearly 2 years after Katrina and Rita struck the Gulf Coast, we are still trying to understand why this public-private partnership broke down and what it is going to take to fix it.

In my own district, which is more than 1,200 miles from New Orleans, my neighbors have had their own struggles with flooding. In fact, some of my constituents are still living in FEMA trailers, nearly a year after 2006's flooding.

The NFIP and FEMA's other flood-related programs must work better. We must find a happy medium, and that medium must include proper oversight.

I am troubled, as I'm sure most of us here today are, by the news that private insurance companies may have manipulated FEMA to pay out claims for which FEMA should not be responsible. If that's true, it is simply despicable.

I recently took a trip down to the Gulf Coast to see how the recovery was going. The people down there aren't looking for a handout, they are just looking for a hand up. They just want to rebuild and get on with their lives. And I hear the same sentiments from my neighbors, who are still waiting for their claims to be paid.

That said, when insurance is using every legal loophole and tactic to avoid paying out on a claim they should be responsible for, the system is broken, and as far as I'm concerned, if that system is broken, it is a disservice to not only the citizens who have come to rely on it, but also the country as a whole.

I know that Chairman Thompson, when he arrives, and Ranking Member Rogers also have a lot to say, so I won't take up much more time. I just want to emphasize that this is only the beginning of a new chapter in the oversight of the NFIP.

I'm looking forward to continued cooperation from the Financial Services Committee when it comes to examining the insurance meltdown that resulted from the 2005 hurricane season.

Hopefully, any changes that we can help bring about will mitigate problems we've seen elsewhere across the country with NFIP payments.

With that, I yield back, Mr. Chairman.

Chairman WATT. I thank the gentleman for his statement, and I welcome the members of the Homeland Security Committee to our humble facility over here. Thank you for being here.

I will now recognize Representative Rogers from Alabama for 5 minutes.

Mr. ROGERS. Thank you, Chairman Watt, and Chairman Carney, and I want to join you in thanking the witnesses for taking time to be here with us today.

Let me say at the outset that it's a special privilege to participate today with my good friend and colleague, Spencer Bachus, from Alabama, as well.

The folks in Alabama are fortunate to have a member of their State's congressional delegation serve as the highest ranking Republican on the Financial Services Committee.

This joint subcommittee hearing will examine issues that came to light in the National Flood Insurance Program after Hurricanes Katrina and Rita.

Just last week, our Management Subcommittee held a field hearing in the storm-ravaged area of Mississippi's Gulf Coast. We saw firsthand some of the extent of devastation that was caused by Hurricane Katrina.

Almost 22 months after Hurricane Katrina, many of the damaged homes remain gutted because of disputes over insurance coverage, and many lots remain vacant because folks can't get affordable insurance to rebuild.

In our meetings with State and local officials, we heard about some of the challenges folks along the Gulf Coast are facing within insurance claims.

The insurance department in my home State of Alabama learned a number of lessons after Hurricane Ivan in 2004. Therefore, after Hurricane Katrina struck, the department set up operations at each of the FEMA disaster recovery centers and sent staff to shelters throughout the State.

One of the main issues today affecting insurance coverage is whether damage to a private home was caused by wind or water. Homeowners insurance generally covers losses from wind and wind-driven rain, but not from flooding or flood-driven water.

The Federal Government underwrites flood insurance through the National Flood Insurance Program. One of the problems we will hear about today is how the flood insurance program is seriously underfunded. Currently, the program is borrowing several billion dollars to cover losses from Hurricane Katrina that are estimated to be around $25 billion.

Another problem is how gaps occur in the homeowners policies that result in lack of insurance coverage when damage occurs and problems exist in how the National Flood Insurance Program interacts with States.

We look forward to hearing from our witnesses today about these and other problems that have arisen in the aftermath of the hurricanes in 2005, and what steps can be taken to fix them.

Thank you, Chairman Watt, and I yield back.

Chairman WATT. I thank the gentleman.

I now recognize Representative Wexler from Florida for 5 minutes.

Mr. WEXLER. Thank you, Mr. Chairman. I won't take the full 5 minutes.

I just want to thank you, Mr. Chairman, for calling this hearing.

Mr. Carney talked about an insurance meltdown, and while many States have their extraordinary stories, Florida has been struggling with the devastating consequences of particularly Hurricanes Katrina and Rita, and what this struggle and the ensuing insurance meltdown has established is that there is an essential role for the Federal Government to play.

Congressman Klein, Congressman Mahoney, and I are working together with others in the Florida delegation to follow what our State legislature did, which was to eliminate certain things like cherry-picking and to undo some of the rate increases that happened after Katrina and Rita, but what it showed was that the re-

lief to Floridians was fairly limited, and the logical next step is for there to be a comprehensive national catastrophic insurance fund that is created, which increases the capital available to the private insurance market, which caps the liability of insurance companies in the context of a national disaster with an absolute requirement that it be homeowners that benefit from the changes and the reforms, and that it not simply be an opportunity for the insurance companies to gain more profits.

Mr. Chairman, I again congratulate you for holding this hearing, and for those of us in Florida who have watched the insurance meltdown and it's creating all sorts of negative economic ramifications in the context of real estate and so forth, we implore you and the rest of this committee to urgently consider a national catastrophic insurance fund.

Thank you very much.

Chairman WATT. I thank the gentleman for his opening statement. I now recognize for 5 minutes the gentleman from Alabama—who has already been raved about by his colleague from Alabama, and is no doubt basking in that raving—Mr. Bachus, the ranking member of the full Financial Services Committee.

Mr. BACHUS. Thank you, Mr. Chairman. I want to commend you and Mr. Carney for convening this hearing, and I also want to recognize Ranking Members Miller and Rogers for the hearings they have held and for the bipartisan concern that the victims of these hurricanes are being treated fairly when their claims are being adjudicated by the insurance companies.

Our focus after the hurricanes—Katrina, Rita, and Wilma—when we really saw a record number of losses, $60 billion in losses, our first priority was trying to get immediate relief to the victims, and this committee tried to act post-haste in that regard, and we passed several pieces of legislation.

We also acted to commission a report by GAO to determine whether insurance claims and insurance adjusters were being properly regulated and overseen as they adjudicated these claims, and to also make recommendations for strengthening consumer protections with regard to future natural disasters when we begin to hear some disturbing reports about how citizens were being treated and their claims being handled.

Congress also enacted legislation last year directing the Department of Homeland Security Inspector General to conduct a similar inquiry of Katrina-related flood claims as a parallel investigation to our GAO investigation, and today's hearing, as the chairman said, was meant to focus on the preliminary findings of those two investigations.

These initial reports that we've received from both GAO and Homeland Security Inspector General are troubling on a number of levels.

While they say they haven't discerned any pattern of abuse or illegal activities, it appears that neither they nor the State regulators have the information necessary to make this determination with any confidence.

In fact, as late as our February oversight hearing on this matter, we were assured that the quality oversight had not been compromised, but the reports today call that into question.

Following any disaster, the government and private sector must work together to adjust claims and remit compensation. This coordination is important to ensure that consumers are fully compensated and not subject to competing claims analysis that can potentially be doubly adverse and result in no payment or unfair payment.

But coordination of claims adjustment can also create potential conflicts that must be carefully supervised. Members have heard allegations that entities may have improperly shifted costs or charged higher reimbursement rates to the Federal Government, and thus to the taxpayers. We expect and want companies to earn a profit, but not by shifting costs illegally to taxpayers.

With tens of thousands of claims being processed, mistakes are inevitable, but if our investigations determine that there's been a pattern of misbehavior, conscious wrongful behavior, or intent to defraud, the offenders must be held accountable and their behaviors corrected.

Let me conclude by thanking our witnesses for being here today and for their willingness to provide additional information and insight.

Chairman Watt, I particularly look forward to working with you in a balanced, bipartisan manner, and with the chairman and ranking member of Homeland Security, as well as Mr. Miller, as we continue our congressional followup to ensure that all parties, including victims and taxpayers, have been and will be treated fairly in the future.

Chairman WATT. I thank the gentleman for his statement, and I am pleased to ask unanimous consent that members who do not serve on either the Financial Services Committee or the Homeland Security Committee be allowed to sit on the dais and join us for this hearing.

Without objection, it is so ordered.

And I'm pleased to welcome two members from the Gulf region and ask them to give us opening statements, also.

I will now recognize the gentleman from Mississippi, Mr. Gene Taylor, for 5 minutes.

Mr. TAYLOR. Thank you, Mr. Chairman, for your extraordinary courtesy.

Mr. Chairman, in light of today's hearing, I would hope several things that have come out both in the South Mississippi Sun Herald and the Times Picayune articles that have been published as recently as today call into mind apparently the widespread misuse of the National Flood Insurance Program.

If you were to read the Sun Herald on a daily basis, you would hear horror stories of how individuals have been ruled in court to have been cheated out of their homeowners policies.

If you were to read the Times Picayune, it leads to a slightly similar and slightly different conclusion, that in the course of telling individuals that your plan isn't going to pay, that it's all flood, that the taxpayers have been stuck with the tab for claims that should have been paid by the private sector.

Mr. Chairman, in light of today's article in the Times Picayune, I would ask that this committee subpoena records of a September 7, 2005, meeting between the Administrator of the flood program,

David Maurstad, and approximately 300 insurance agents, in which he outlined the National Flood Insurance Program's attitude towards the whole wind versus water issue, because based on something that Mr. Maurstad said in this room, where he said, "I instructed them whenever there was wind and water to pay the flood claim in full," I'm not sure he has the legal authority to do that.

The way I read the United States Code, it says, and I'm reading 44 CFR 62.23:

"The entire responsibility for providing a proper adjustment of combined wind and water claims and flood alone claims is the responsibility of the Write-Your-Own company, which is a private sector company, which has been hired to sell the policy and adjudicate the claim."

It is further complicated by a memo to the State Farm Insurance Company dated September 13, 2005, and I quote, where they say:

"Where wind acts concurrently with flooding to cause damage to the insured property, coverage for the loss exists only under flood coverage."

So on one hand, the United States Code gives them the responsibility to sell the policy and adjudicate the claim, and yet a State Farm memo to its agents tells them that whenever there's wind and water, blame it all on the water.

So that person who had a homeowners policy, they suddenly were not going to get paid on that homeowners policy.

But for individuals or taxpayers who don't live in the affected area, suddenly we see a circumstance where we feel like the Federal Government has been billed for claims that should have been paid by the private sector.

I would also like to enter for the record a series of articles from the Times Picayune where it spells out that homes that had zero flood damage still billed the National Flood Insurance Program $80,000, $100,000, $150,000, whatever the private sector felt like they could stick the taxpayers with.

Again, this leads to a series of troubling situations in which some attorneys in the Louisiana area have filed suit just last week under the Fraudulent Claims Act, claiming that possibly billions of dollars of claims that should have been paid by the private sector are being paid for by the National Flood Insurance Program.

Mr. Chairman, as a representative of the coastal area, I am pleased that I didn't have a single complaint from individual homeowners who felt like their flood insurance program wasn't fair with them. I think that's a good thing.

On the flip side, I've had thousands of complaints from homeowners who said, "I built my house the way they told me to, I paid my premium, and when the day came to file my homeowners claim, I was told that because I couldn't prove whether the wind got there first or the water got there first, that I would be receiving nothing on my homeowners policy."

In fact, one of the more interesting cases involves a doctor who lives 100 yards from me, who for years was an advocate of tort reform, who is now on a commercial calling for insurance reform, after his almost $900,000 policy was not paid by State Farm.

So Mr. Chairman, I think there are some very interesting questions that involve individuals and their policies, that involve Americans collectively, and certainly something that, on behalf of the 52 percent of all Americans who live in a coastal community, who if it hasn't happened to them yet, could certainly happen to them next. These are the sort of questions that I would hope this committee and other committees in Congress can get an answer to.

Thank you very much for letting me participate.

Chairman WATT. I thank the gentleman for his opening statement, and I've been reminded that my unanimous consent request was less than articulate, which is not unusual, so let me state it again.

Let me ask unanimous consent that, in addition to being allowed to sit on the dais, members, including Mr. Taylor and Mr. Jindal, who may not be members of either of the subcommittees, be allowed to make opening statements to the extent that the timeframe allows that to happen, and to be able to ask the witnesses questions at the end of the committee process.

Hearing no objection, I will now recognize Mr. Jindal from Louisiana for 5 minutes, hopefully the last opening statement.

Mr. JINDAL. Thank you, Mr. Chairman.

I also want to thank the ranking members for allowing me to participate today and for having this hearing.

It has been nearly 2 years since Hurricanes Katrina and Rita devastated the Gulf Coast, including large areas of my home State of Louisiana.

We now know that Katrina was the single most significant natural or manmade disaster to affect our country. The combined effect of those 2005 storms—Katrina, Rita, and Wilma—caused nearly $60 billion in losses.

Over half of our country's population now lives along the coast in 673 counties and parishes. In areas such as these, many residents are required to purchase at least two insurance policies—the required flood insurance, in addition to a regular homeowners insurance policy that offers wind coverage.

As most of us living in coastal areas know well, the National Flood Insurance Act allows homeowners to purchase up to $250,000 of NFIP insurance coverage for residents, an additional $100,000 for personal property. Exclusions under the flood policy include damages caused by wind or a windstorm.

While FEMA is charged with management and oversight of the National Flood Insurance Program, it is our brand name insurance companies that sell and service the vast majority of these flood policies. These companies get premiums from selling the insurance, but they're not responsible for actually paying out claims.

Taxpayers like you and I collectively, the citizens, the taxpayers of our Nation are responsible for paying flood claims filed by NFIP policyholders.

As it turns out, the amount each insurance company receives for selling a flood policy varies by company.

Each is currently, "reimbursed"—that's the terminology the NFIP uses—at a basic rate of 30.8 percent for the expenses of selling, working with the NFIP to issue policies and settle claims.

There are bonus percentages available in 1 percent increments for marketing and growth.

Let me underscore what I've just said. Taxpayers, through the United States Treasury, are responsible for paying flood claims. That's an important point in light of the following.

In 2006, after the worst hurricane season ever recorded, insurance companies, even after all those damages, continued to have a very profitable year.

We're here in part to find out whether the American taxpayer improperly picked up the tab for insurance claims that should have been paid by these companies.

We'll hear from our witnesses from the GAO and others, we'll hear about a potential weakness in the way that our flood insurance program is administered.

For example, a property and casualty insurer is able to insure a single property for both wind and flood damage.

Potential conflict of interest can arise when the insurer, who has a financial interest in minimizing claims paid by the company, also performs a claims analysis on behalf of the NFIP.

In other words, a single company can determine and apportion the damages caused by the wind policy that it insures along with those caused by flooding, which is insured by the NFIP and paid for by the Federal Treasury.

In the aftermath of an event as large as Katrina, it was certainly difficult at times to determine whether the source of damage was either wind destroyed the top of the roof and allowed a property to flood, or if the damage was caused by rising floodwaters and failed levees.

Moreover, the NFIP does not collect the information it needs to help evaluate whether it has paid only what it is obligated under the flood policy.

While we appreciate that after those hurricanes, the NFIP approved expedited claims processing to make sure that homeowners were not prevented from rebuilding by red tape, we must ensure, we must correct the fact that the NFIP's normal claims processing activities did not incorporate a means to systematically collect information on wind versus flood-related damages.

As we discover more about this crack in the system by which flood insurance is administered, we must have the strongest safeguards to prevent insurers from deliberately categorizing wind as water damage, therefore allowing them to potentially shift costs to the Federal Government without any oversight.

I certainly hope, Mr. Chairman, as we have these hearings, we'll also have the chance to discuss in a future hearing a bill that Mr. Taylor and I have offered, H.R. 920, the Multiple Peril Insurance Act. That bill would allow policyholders to get their wind and flood coverage combined, therefore avoiding the fight between the source of wind and flood coverage.

I also want to echo the comment of my colleague from Florida calling for a hearing on national reinsurance, which I think is also called for.

Mr. Chairman, again, I thank you for allowing me to participate, and I thank you for having this hearing, to make sure we're protecting not only policyholders, but also taxpayers.

Chairman WATT. I thank you for being here.

It has been called to my attention that Mr. Jindal is a member of the Homeland Security Committee, so I misstated that, and I thank him for being here.

Without objection, all members' opening statements will be made a part of the record.

Chairman WATT. Mr. Klein, did you want to make an opening statement?

Mr. KLEIN. I do, yes.

Chairman WATT. Okay. In that case, let me recognize Mr. Klein for 5 minutes.

Mr. KLEIN. Thank you, Mr. Chairman, and thank you, chairs of both committees, for calling this meeting today.

Those of us who live in States that have been hit by hurricanes over the last number of years also understand the history of the National Flood Insurance Program, because it's something that impacts people all over the United States.

And one of the original reasons for it was that the insurance industry was unwilling to, based on their view of the risk, underwrite that risk at that time, and because the capacity was too large, among other reasons, and that's how the plan got to its place right now.

I think there's broad recognition that there needs to be updating of mapping and technology to make it more efficient, but I think one of the subjects we're going to hear about a little more today is the efficiencies of how it administered the claims and how that operates vis-a-vis the private insurance that some of the folks in the areas that were impacted had.

The problem we saw in Florida was very similar, and I won't rehash what was already discussed.

But suffice it to say what I believe is going on is that there is a narrowing of responsibility of the private insurance side of things.

Insurance is a contract. The private insurance contract is one between a homeowner and between the company, and it's obviously always subject to interpretation, but what we saw over the last few years in these major disasters where there was a wind versus water pointing of the fingers going both ways, it was something that everybody was trying to put the burden on someone else, which is obviously why we're having a serious problem in dealing with general insurance, homeowners and property and casualty insurance, as well.

So I certainly look forward to the opportunity of figuring out through the testimony today what can be improved upon in the National Flood Insurance Program, whether or not the history over the last number of years is one in which there could be things done differently so that, on a going forward basis, the floodplain does what it's supposed to do.

But I think this will hopefully also be helpful to us in understanding what is going on in the rest of the market of insurance so that we can put the proper burdens that are bargained for in an insurance contract on those that provide underwritten insurance.

And to the extent that we see, whether it's natural disasters such as earthquakes, hurricanes, tornadoes, or any number of other non-flood types of insurance arrangements, that there needs to be fairness.

Consumers should be prepared to pay a fair price that's actuarially based, but at the same time, insurance is a for-profit business. We understand that. But it's not one in which they should be constantly looking for the other party or the homeowner, in many cases, to shoulder that burden.

A bargain is a bargain, and we need to make sure that when that bargain is bargained for, it's held.

So Mr. Chairman, thank you for doing this today. Hopefully, this will help us evaluate what we need to do in this area, as well as a national risk catastrophe arrangement.

Chairman WATT. I thank the gentleman for his opening statement.

I'm pleased now to introduce the witnesses who have joined us for today.

First, Mr. Matt Jadacki, who is the Deputy Inspector General for the Office of Disaster Assistance Oversight for the U.S. Department of Homeland Security.

The Office of Disaster Assistance Oversight is tasked with proactively implementing internal control reviews and contract audits to ensure that disaster assistance funds are being spent wisely, and Mr. Jadacki is also responsible for coordinating the audit activities of other Federal Inspectors General who have an oversight responsibility for the funds transferred to their respective Departments and Agencies by FEMA to assist in the disaster relief efforts.

Prior to taking this position, Mr. Jadacki was the Chief Financial Officer and Chief Administrative Officer of the National Weather Service, a component of the National Oceanic and Atmospheric Administration. And before that, he was the acting CFO of FEMA, managing 11 branches with over 200 employees.

He holds a B.S. degree in business management from the University of Maryland at College Park, and we won't hold that against him, even though I'm a Carolina graduate.

Our second witness today will be Ms. Orice M. Williams. She has spent 16 years in civil service at the Government Accountability Office. She is currently a Director in the GAO's Financial Markets and Community Investment team, and in this capacity, she is responsible for leading numerous teams that work on a variety of cost-cutting public policy issues in the financial services sector.

Her portfolio of work is generally concentrated in securities and futures oversight, banking, insurance, and accounting policy, and she received an MBA with a concentration in finance from Virginia Tech in 1990, and a B.S. degree in business and finance from Virginia Commonwealth University in 1988.

Mr. Jadacki and Ms. Williams, we thank you both for being here. Without objection, your written statements will be made a part of the record, and each of you will be recognized for a 5-minute summary of your testimony.

There is a lighting system that's in front of you, and a yellow light will come on when you have a minute to go, and then a red light will come on, so just kind of wrap up at that point. We won't

be too heavy handed about that, but be cognizant that the lighting system is alerting you to wrap up.

Mr. Jadacki, you are recognized.

STATEMENT OF MATT JADACKI, DEPUTY INSPECTOR GENERAL FOR DISASTER ASSISTANCE OVERSIGHT, OFFICE OF THE INSPECTOR GENERAL, U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. JADACKI. Thank you. Good afternoon, Chairman Watt, Chairman Carney, members of the subcommittee, and guests.

As you may be aware, in the Department of Homeland Security 2007 Appropriations Act, we, the Inspector General's Office of the Department of Homeland Security, were directed to investigate whether and to what extent insurance companies participating in the National Flood Insurance Program, referred to as Write-Your-Own companies, improperly attributed damages from Hurricane Katrina to flooding rather than to windstorms covered under homeowner policies or wind insurance pools.

First, let me give you a little background on the Write-Your-Own companies. Homeowner insurance policies typically cover wind, but not flood damage. Write-Your-Owns are private sector insurance companies authorized by the National Flood Insurance Program to sell insurance.

The Write-Your-Own companies have no financial exposure when damage is caused by flood because the Federal Government, through the NFIP, reimburses the Write-Your-Owns for claims they pay.

Although the NFIP does not have direct control over the Write-Your-Owns, the Write-Your-Owns agree each year to the terms and conditions with the Federal Emergency Management Agency on various compliance and business issues. This agreement provides, among other things, that the Write-Your-Owns will comply with the written standards, procedures, and guidance issued by FEMA.

We reviewed a number of claims files in three Mississippi counties, analyzed the legal opinions, reinspection reports, and the NFIP complaint files. We also spoke with officials from FEMA, Mississippi Insurance Association representatives, insurance adjustors, Write-Your-Own officials, and other experts.

It is important to note that we did not have the same access to the Write-Your-Own records of wind claims as we did to the flood claims that are funded by the Government. The wind claims are likely placed to find indications that the Write-Your-Owns may have attributed wind damage to flooding.

We have, however, issued administrative subpoenas for those records. We will issue a final report after we have received and reviewed the Write-Your-Own records of wind claims.

Storm surge flooding was the primary cause of damages sustained along the Mississippi coast, but high wind velocity before the surges and water also caused damage.

The central question is whether the Write-Your-Own companies, in settling claims, may have improperly attributed damage caused by wind to flooding in order to avoid liability under the standard homeowners policy. The question is especially relevant in situa-

tions where the same Write-Your-Own held both the homeowner and flood policies for the insured property.

To answer these questions, we analyzed flood claims, and we interviewed homeowners, flood adjustors, and representatives from insurance associations and Write-Your-Own companies. We discussed with FEMA officials, looked at quality controls, and we reviewed appeals and complaint files.

Although nothing came to our attention from our work on solely the flood claims to indicate the Write-Your-Owns attributed wind damage to flooding, we cannot rule out the possibility that it occurred.

Flood adjusters were professionals and based their determinations on the physical evidence they observed, however, there are several complicating factors that contributed to a perception that Write-Your-Owns may have attributed wind damage to flooding, such as difficulty in distinguishing wind and flood damage, especially when there was nothing left on the property except for a foundation, otherwise known as a slab.

Language in homeowners insurance policies can exclude coverage if funding occurs concurrent with wind or other causes of damage. Adjusters are either working for the Write-Your-Own companies or for companies hired by Write-Your-Owns. This creates the perception of a conflict of interest and FEMA's oversight of Write-Your-Own companies is limited and needs improvement.

FEMA needs to increase oversight over damage claims that involve both wind and water on the same structure. Our review of the flood claims indicated that payouts on flood claims were timely and complied with the NFIP terms. However, there is little evidence in the flood claim files to determine whether flood payouts were fair and equitable for damages caused by both wind and water affecting the same structure. In addition, FEMA did not maintain documentation indicating the total damage to a structure and how much was attributable to flood and wind, nor is it required by the National Flood Insurance Program.

As a result, NFIP oversight focused primarily on whether the flood claim was correctly adjudicated, with little or no consideration for wind damage as a contributing factor. Under the current process, it is difficult to determine whether the NFIP paid a higher percentage or the entire damage claim involving both perils.

We will be issuing an interim report in the next couple of weeks, and we will have recommendations for the FEMA Administrator.

The first recommendation: require Write-Your-Own insurance companies to document and make available to the NFIP the rationale and methodology for calculating flood and wind damage when there's evidence that both perils contributed to the damage, and revise the NFIP claims adjustor manual to reflect these requirements.

The second recommendation: expand the reinspection process to include review and determination that flood and wind damage on the same structure was settled in a fair and equitable manner to ensure that wind damage was not paid under the flood policy.

Third: provide clear and concise guidance for adjusting total loss claims after catastrophic events when structures are completely destroyed by wind and water.

As I stated earlier, we issued administrative subpoenas for the Write-Your-Own insurance company records, providing both wind and flood coverage.

We plan to corroborate the documentation and assertions made in our review to determine whether and to what extent damages were improperly attributed to flooding rather than wind. We also plan to compare whether unit pricing for like materials paid under flood and wind claims were consistent and reasonable. We will issue our final report upon completion of our wind claim analysis.

Chairman Watt, Chairman Carney, this concludes my prepared statement. I will be pleased to answer any questions you or other members of the subcommittee may have.

[The prepared statement of Mr. Jadacki can be found on page 40 of the appendix.]

Chairman WATT. Thank you so much.

Ms. Williams.

STATEMENT OF ORICE M. WILLIAMS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, GOVERNMENT ACCOUNTABILITY OFFICE

Ms. WILLIAMS. Chairman Watt, Chairman Carney, and members of the subcommittees, I am pleased to be here this afternoon to discuss the National Flood Insurance Program, also known as NFIP, and FEMA's oversight of flood claims paid following the 2005 hurricane season.

As you well know, events such as hurricanes can pose particular challenges in determining damages caused by wind versus flooding.

For the NFIP, this includes balancing its desire to make policyholders whole and ensuring that it pays for damages caused by flooding.

Unlike past years, the 2005 hurricane season has placed increased scrutiny on the NFIP's internal controls and FEMA's oversight, given the more than $15 billion borrowed from Treasury to cover claims, and the likelihood that the NFIP will be unable to repay this debt.

While our work in this area is ongoing, I would like to share a few preliminary observations.

First, for properties experiencing both wind and flood damages, the NFIP did not consistently collect information that would enable it to determine, either at the time the NFIP claim was paid or later, whether the amount paid reflected only damages caused by flooding.

Claims data collected from Write-Your-Own insurers, which are a network of property casualty insurance companies that sell and service flood policies on behalf of the NFIP, did not include information on total damages to the property from all perils, meaning they did not systematically report the existence of wind damage nor the amount of damage caused by wind when adjusting a flood claim, even when the Write-Your-Own insurer was also the wind insurer on the same property.

Why, you ask. According to FEMA, claims paid by a Write-Your-Own insurance company that do not involve flood insurance proceeds and the related data are not accessible by FEMA.

Simply put, for hurricane damaged properties subjected to both high winds and flooding, the NFIP may not have all the information it needs to ensure that it's claims payments are limited to only flood damages. This is especially troublesome in cases where only foundations remained.

Second, we found that this lack of wind data also limited the effectiveness of FEMA's quality assurance reinspection program, an important part of FEMA's oversight of the NFIP.

Specifically, the FEMA quality reinspection program did not incorporate a means for collecting and analyzing both the flood and wind damage data together in a systematic way to determine how much wind and flooding contributed toward damages to a property.

Without the ability to examine the damages caused by both wind and flooding, the reinspection program is limited in its usefulness as a tool to assess whether the NFIP paid only for losses caused by flooding.

Before I conclude, I would also like to briefly discuss challenges we face obtaining key information and data from FEMA related to several ongoing engagements involving the NFIP.

To date, we have faced extensive delays in obtaining requested documents and data from FEMA, which is impacting our ability to complete our work in a timely manner.

Now, instead of program staff being able to provide requested information directly to us, it must be routed through a FEMA coordinator who shares it with general counsel and DHS reviewers before it can be sent to GAO.

Given this elaborate review process, we have had to add several months to the length of our engagements, which is threatening our ability to provide timely information to our requestors and the Congress as it considers legislation that would directly impact the NFIP.

In summary, we cannot assess whether the NFIP paid for claims that should have been paid by property-casualty insurers given the lack of information collected by the NFIP on wind-related damages.

Moreover, we found the existing oversight structure did not allow FEMA to determine whether certain claims paid were accurate.

While we are making no recommendations today, we do anticipate recommendations in our final report to be issued later this year.

This concludes my oral statement, and I would be happy to answer any questions that you may have.

Thank you.

[The prepared statement of Ms. Williams can be found on page 58 of the appendix.]

Chairman WATT. Thank you, Ms. Williams. I thank both witnesses for their testimony, and I will recognize myself for 5 minutes for questioning.

Let me ask unanimous consent first to submit for the record an editorial from the Times Picayune dated June 10, 2007, and ask unanimous consent to submit for the record a copy of the complaint that was filed in United States of America ex rel Branch Consultants v. Allstate Insurance Company and a number of other insurance companies.

Mr. BACHUS. Mr. Chairman? Will members of the committees be supplied with a copy of—

Chairman WATT. Yes, absolutely.

Mr. BACHUS. I have no objection.

Chairman WATT. Without objection, these documents will be submitted for the record.

Chairman WATT. The first question is one I want to ask both witnesses. I submitted for the record, under a unanimous consent request, the appropriations language that authorized your study and the letter from Mr. Oxley which authorized one of the studies. One of the concerns I have is whether you have pursued the studies as aggressively as those documents give you the authority to pursue them. It appeared to me that most of what was done had to do with the internal records of FEMA and the flood insurance program, with the exception of the administrative subpoenas that have been issued.

The question I want to ask is, to what extent have you gone outside the flood insurance program's records to inquire about potential abuses of the program in this process?

Mr. Jadacki?

Mr. JADACKI. Okay. I mentioned before that the administrative subpoenas were issued because we did talk to different insurance companies to discuss their methodology, how they would determine if there were two perils involved, both flood and water, how would they make a determination of allocating the adjustment or the claims.

When we asked for the files to corroborate what they said, we were told that we didn't have access to those, and also there's a legal opinion that FEMA put out that says that they do not have that.

So we focused a lot of our work initially thinking we can get a lot of information out of the flood files, thinking there would be some documentation in the files that would indicate there was consideration of wind and other types of peril that occurred, but when we finished our work, it just wasn't there. You may see a box that was checked for flood or something like that.

So we talked to a number of the insurance companies, I think 15 different insurance companies. We actually contacted 35 of the insured, if they were willing to talk to us, to see if they were satisfied with their settlement or not.

We talked to insurance industries, we did talk to some of the State folks, and we did talk to some of the other folks involved in the insurance industry.

We tried to look at every bit of information that was out there, but we were unable to get our hands on the homeowners policies from the insurance companies.

So we have what we need on the flood side. It's just that we need to corroborate with what they were saying, because in almost all cases, yes, we do pay, there is a methodology, there's some—there's a way of allocating those costs. We just haven't been able to corroborate that yet.

Chairman WATT. Ms. Williams?

Ms. WILLIAMS. Our experience was similar.

We followed a similar process. We talked to the NAIC and State insurance commissioners, among others. We also collected from the NAIC the information that had been collected by the Gulf Coast States through a special call involving the property-casualty claims that had been paid.

But we found that information was collected on an aggregate basis, and we weren't able to get to ZIP Code level information that would have helped us do any type of comparison.

We also attempted to contact insurance companies and we found that the insurance companies were generally unwilling to meet with us or provide us information.

Part of our larger study deals specifically with adjusters, including how the adjusters are overseen and regulated. We were able to collect that information from the States.

But in terms of getting information from the insurance companies, such as how they actually apportion damages, we weren't able to get information such as adjuster manuals.

Chairman WATT. Mr. Jadacki, on Page 3 of your written testimony, you indicate that you interviewed 20 flood adjusters who did some of the damage investigations for the properties, and these adjusters were not involved in any wind damage assessments, felt that they were not under pressure from the Write-Your-Own program to attribute wind damage to flooding.

If I take the Times Picayune article and the complaint which I've submitted for the record, there seems to be a completely different picture being painted here.

Have you had the opportunity to talk to any of the adjusters who are plaintiffs in the lawsuit which alleges massive pressure and misallocation to the flood insurance program?

Mr. JADACKI. We just got a copy, I think the lawsuit was sealed until about a week or two ago, so we just got a copy of the lawsuit, as well as some of the addresses, and we will be pursuing those. We have already asked the NFIP for copies of those files to find out what's going on.

Especially troubling is when it's alleged that there's no indication of any water being involved in some of those structures, and yet the claims were paid out, so it's part of our process of reviewing some of the information on the additional claims files. We'll probably also talk with the insurance companies about those files, too, and try to get to the bottom of that, also.

Chairman WATT. Does the letter from former Chairman Oxley and the appropriations language give you sufficient authority in your opinion to get to the bottom of whether there was in fact an improper transfer of responsibility following the hurricanes?

Mr. JADACKI. We can look at claims files and infer what happened, looking at the claims files, but it's trying to get, attempting to get information from the insurance companies about the other half of the equation, if there was damage, both wind and water, has been problematic. We have not been able to get that information.

As I said, we've issued subpoenas for that information, and we've received a couple, but I haven't had a chance to analyze those yet.

Chairman WATT. My time has expired, and I recognize the ranking member of the subcommittee, Mr. Miller, for 5 minutes.

Mr. MILLER. Mr. Jadacki, following up on that, we heard from Director David Maurstad earlier in the year, as FEMA Director, and we were very specific in what we were talking about, and he said that they had reviewed thousands of files, basically reinspected those files to see what was in them, to see if there was any pattern of abuse by Write-Your-Own companies. And he was very specific at that point in time that there was not. Now, have you had an opportunity to review those same files that he reinspected?

Mr. JADACKI. Yes. We reviewed a number of reinspection files, and for the most part, a lot of the reinspection focuses on documentation—was the documentation in the file, were proofs of loss filed, were the insured there, some of those types of things.

I don't think we found any cases—we found a couple of cases where some dollar amounts were disputed, but they were negligible amounts, a couple hundred dollars, and that was about it.

But we found no cases where a reinspection, based on the reinspection report, an insurance company was challenged based on the payout, saying, based on our review, you should have paid wind, you shouldn't have paid water, we found none of that.

Mr. MILLER. Was there adequate information requested by the director of the insurance companies that was in those files to make a reasonable determination on whether the oversight was proper on the Write-Your-Own, or if it was improper? Did you—

Mr. JADACKI. The inspection files focused solely on the flood payout.

Was there a property here, looking at watermarks, was it correctly adjusted, again were the documents in the case, those types of things.

We found no indications that it actually challenged, saying this appears to be a wind claim, why did you pay the flood claim? We came across none of those instances.

Mr. MILLER. Did you find any inconsistencies within his finding as far as what FEMA did when they reinspected the NFIP's claims? Were they adequately reviewed, the NFIP's claims, do you believe?

Mr. JADACKI. I believe they were—they probably used the checklist approach, just looking at a number of different documents and what to look for in the file and whether, again, whether there was documentation in the file, there were some pictures, and those types of things, but again, I think it was more of an administrative review versus reviewing or challenging the adjudication process.

Mr. MILLER. Now, you're just in the process of collecting information. How far into that process do you believe you actually are at this point?

Mr. MILLER. Well, we've reviewed all the claims files from the flood insurance, so those files were readily available to us, because that's under the purview of the Department of Homeland Security, and, you know, we've looked at a lot of those files.

And there are indications in there, in some cases, looking at pictures that a tree may have fallen on a house or a roof may have been damaged, but we know what the flood payment was, but there's literally nothing in some of the files that say, okay, in addition to the flood payment, there was a wind, something that was caused, damaged by the wind, whether it be a roof blowing off or

a tree blowing on a roof, and those types of things. There's just very little evidence in the files that actually occurred.

As I mentioned in my testimony, I think the adjusters did a real good job of adjusting the flood claims, but it remains to be seen about what type of job they did when they were actually allocating the losses between flood and wind, if they even did that.

Mr. MILLER. So looking at the flood issue, you're pretty much in agreement with what FEMA's conclusions were based on the work they did?

Mr. JADACKI. Solely on the flood insurance.

Mr. MILLER. How do we, through the process you're undertaking, how do we ensure that Write-Your-Own insurance companies do not have the ability to defraud the NFIP when a structure endures wind and flooding at the same time?

Is there going to be something you're doing that you're going to come back to us, and can you give us some kind of an idea when that conclusion is going to occur, how long the process is going to—

Mr. JADACKI. We're going to issue an interim report hopefully in the next couple of weeks, and I mentioned in my opening remarks—

Mr. MILLER. In the next couple of weeks?

Mr. JADACKI. In the next couple of weeks, an interim report, just based on the work on the flood insurance claims files, and then once we get the information from the insurance, we'll issue a final report sometime later on this summer.

Mr. MILLER. But as it applies to Write-Your-Own, to have—we're looking for a complete report here—

Mr. JADACKI. Right.

Mr. MILLER.—on not only flood but one on wind, and the Write-Your-Owns, we want—how long do you think it will take you to have that conclusion on Write-Your-Owns also?

Mr. JADACKI. It depends when the insurance companies deliver the documents. The due date was June 8th, although we haven't received all of the documents, because they go through the mailing process at Homeland Security, and screening.

It all depends on what's in those files, you know. If we get a little bit of information, it could be pretty quick. If there are a lot more questions we have to go back on, it may be a little bit longer than that.

The reason we're issuing an interim report is that there are some issues that the NFIP needs to address immediately, and one of those issues is the fact that they need to consider if there's more than—if there's wind and water, they need to consider wind, at least put evidence in the file that both perils were considered and one wasn't excluded just because, you know, because of causation clause and those types of things. So we think there needs to be evidence in the files to indicate that, yes, other perils were considered.

Mr. MILLER. Will your report include aspects of existing NFIP claims adjustment procedures? Should we be revisiting those to ensure that the conflict of interest would be eliminated in the future, and will you give us some kind of an overview on how that might take place?

Mr. JADACKI. I think in the final report we will be addressing that. In the interim report, I don't think we can address it yet, be-

cause we don't know until we look at the wind files, the homeowner files that we've subpoenaed, just what happened with that, whether they were adjusted in a fair and equitable manner or whether a lot of the costs were in fact shifted to the National Flood Insurance Program, and the reasons why.

Mr. MILLER. Have you been receiving what you would consider a fair and reasonable response from Write-Your-Own insurance companies to get information?

Mr. JADACKI. We had a number of phone calls, conference calls with them to explain what the process is. They all assured us that they had methodologies, they all assured us that there were multiple perils, that they were all considered.

However, we have not had an opportunity to corroborate—

Mr. MILLER. But you're going to?

Mr. JADACKI. We are going to. Right.

We asked for a series of items, claims files, information regarding engineering reports and modeling and some of those types of things when there are two types of damage, two causes of damage to a structure.

Mr. MILLER. It seems like they're going in the right direction, and based on the responses I received, it seems like you're going to do an accurate, complete overview of the process and give us recommendations if there is some failure in portions of it.

Thank you very much, Mr. Chairman.

Chairman WATT. Thank you.

Mr. Carney is recognized for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman.

Before I begin my questions, I want to address my good friend from Mississippi, Mr. Taylor's, concern about the September 7th meeting. I have directed my staff to investigate that already, and we are looking into that.

Ms. Williams, in your testimony you quote a letter from FEMA in which they wrote that wind claims paid by Write-Your-Own companies are, "not accessible by FEMA and indeed do not need to be."

Ms. WILLIAMS. Yes.

Mr. CARNEY. Can you explain what that means?

In other words, what is FEMA's basis for claiming that the wind side of the adjustment process is completely irrelevant?

Ms. WILLIAMS. Well, this is an example of our inability to get information from FEMA. We met with them last week and attempted to address this issue specifically. Until you get to the "conversely," the message seems fairly straightforward, but the "conversely" really changes things.

We tried to find out exactly how they are able to determine the flood damages without having access to anything else from the Write-Your-Own companies if there is wind involved. This is something that we're still trying to work through with FEMA to get an answer about how they're able to do this without getting all of the information.

Mr. CARNEY. And so far, no luck?

Ms. WILLIAMS. Correct.

Mr. CARNEY. Now, this is a process you described, that they are going through multiple channels before they answer you on this?

Ms. WILLIAMS. Yes.

Mr. CARNEY. Okay.

Mr. Jadacki, in your prepared statement, you said that, "Nothing came to our attention during our limited review to indicate that Write-Your-Owns attribute wind damage to flooding," but that you, "cannot rule out the possibility that it occurred."

However, since you haven't seen any claim files for wind damage, is it true that you have not yet reviewed the documents to show whether there was damage attributed to flooding or not?

Mr. JADACKI. That's correct, we have not—I mentioned towards the end of my testimony that we plan to corroborate. We have information from a structure, or a number of structures, that we reviewed, and we know what the flood claim payment was, okay, and there is some evidence, based on pictures and things like that, where, and also testimonial evidence, that the insurance companies said, "Yes, we did pay some wind claims on that structure."

However, we can't corroborate that until we take a look at those files, so once we get the files in on those structures, we can match it up and say, okay, yes, there was some element of flood and there was an element of wind that was paid.

The next step would be, was it fair and reasonable, based on the damages. If it's, you know, if the flood pays $200,000 and the wind only comes up with $500, we're going to question those types of things. So those are the types of things we'll be looking at as we review our claims files for the wind damage.

Mr. CARNEY. Okay. Thank you. No further questions.

Chairman WATT. I thank the gentleman.

Mr. Bachus is recognized for 5 minutes.

Mr. BACHUS. Is there a natural conflict of interest when you have a Write-Your-Own company or an insurance company adjuster that is employed by the insurance adjuster, adjusting both the flood claim and the wind claim, when how he adjusts and computes and pro-rates that damage can either benefit his company or work to their detriment? When he is adjusting for both the Government and the flood insurance program, and his own company, is that a natural conflict of interest?

Ms. WILLIAMS. Our position is that there is definitely the potential for a conflict of interest when that happens.

Mr. BACHUS. Okay. Thank you.

Mr. JADACKI. And I agree with that, too, especially if it's an adjuster who works for the insurance company versus a catastrophic adjuster who works for an independent adjusting firm. But then again, the independent adjusters are also paid by the insurance company, which is reimbursed by the Federal Emergency Management Agency, through the NFIP. So yes, there is an inherent conflict that's out there.

Mr. BACHUS. Okay.

Now, your initial report, and I think both of you really dealt with this, indicates that there's a lack of coordination between FEMA and the Write-Your-Own companies, and that may have contributed to improper payment of claims by FEMA.

There were actually wind claims which may have been the responsibility of the private sector. Is that what—I read your testimony to indicate that you at least have suspicion of that?

Ms. WILLIAMS. About the oversight provided, the oversight of the Write-Your-Own companies by FEMA.

Mr. BACHUS. Is that really insufficient to ensure that doesn't happen, that costs aren't shifted?

Ms. WILLIAMS. Yes, in some situations.

Mr. BACHUS. Okay. So if taxpayers have been asked to pay for non-flood-related damages, you really don't have the information, because of the lack of coordination, to know whether that happened or not?

Ms. WILLIAMS. Correct. We also looked at reinspection files and we found that, while there was definitely the foresight that there was a possibility of having combination claims, the information in the claims files was collected incompletely.

For example, in two-thirds of the files we reviewed, we found that a question about whether or not the damage was combination damage went unanswered, or there were other cases where there was an indication that there was flood damage but there were pictures in the file that indicated wind damage. So there were lots of questions raised in the file review. Even though there was an opportunity to indicate whether or not wind was involved, there was no information recorded..

Mr. BACHUS. Mr. Jadacki.

Mr. JADACKI. I think one of the things that's absent from a flood insurance policy that's common practice in the insurance industry is a coordination clause. They use it in medical insurance, they use it in other types of insurance, where there's several insurance entities that provide insurance over another entity, there's a coordination clause, where they would—and a good example is that recently the insurance companies settled on the World Trade Center.

So they're all talking about who is going to be paying what. You know, if they're all going to pay the same amount and they're going to, you know, get this big windfall, they all know.

What is lacking in the National Flood Insurance Program is that they're operating in a vacuum. They're just looking at what the flood payment was for, and that's it, and they're not considering any other types of peril, whether they contributed or not. And once that flood payment is paid, they've met their contractual obligation, and that's it.

I think a coordination clause would go a long way, that we have to consider other types of insurance and insurance payments out there when adjudicating a claim.

Mr. BACHUS. Let me ask you this. Congressman Taylor has proposed a multi-peril approach where both flood and wind are covered. If that's not done, are there going to be some natural gaps in coverage or questions every time you have a loss of a home, in a case where there's both a flood surge or wind?

Mr. JADACKI. I believe under the current process, you're always going to have that, especially, you know, there's some cases where you have flooding but no wind, and other cases where you have wind but no flooding, but in this case, where you have extreme winds and extreme flooding, and in my written testimony, a lot of the homes on the Mississippi coast were subjected to hurricane-force winds, you know, for 4 or 5 hours sustained before—so the question is, you know, were these structures significantly damaged

before the water came in, but, you know, looking at some of the claims files, it seems like water was the primary cause in a lot of these homes, and I would question that.

Mr. BACHUS. Could I have one more question, if the chairman will allow?

Chairman WATT. Yes, sir.

Mr. BACHUS. In many cases, even from the TV coverage of the hurricanes, you saw cases where wind damage from a storm started to blow a house apart, and then the flood or the surge caused by the storm finished the job. In those cases, at least there have been reports that I've read, by the press and some homeowners, that insurers denied coverage for the wind damage, and they did that through their anti-concurrent causation provisions or clauses.

Are these clauses—it obviously allows them to escape a claim on certain cases, but would you comment on that, either one of you? Did you look at those anti-concurrent clauses?

Mr. JADACKI. Yes, we actually looked at the concurrent causation, the anti-concurrent causation, the proximate cause, the efficient proximate cause. There's all sorts of terminology that's floating around out there, no pun intended, regarding, you know, how they're settling these claims.

I think some of the companies hid behind that anti-concurrent causation clause by saying that it is flood, and that's going to be it, you're denied wind claims, and I think that's pretty prevalent. I think that's a subject of many lawsuits that are out there.

Mr. BACHUS. And you also saw evidence of that?

Mr. JADACKI. We saw evidence of that, right.

But again, we haven't looked at the wind claim files to see if, in fact, they were denied, or whether they did in fact—I think if you asked me a year ago, when a lot of the wind claims were being denied, then yes, I think it was probably prevalent. In the past year or so, a lot of the insurance companies have been stepping up to the plate and paying the insured for wind damage.

Again, once we get the wind files, we'll be able to corroborate that, or say definitely that wasn't the case. But it is out there, and I think it is a way that the insurance companies can protect themselves from multi-perils by saying the clause is in place and we're only going to pay for flood, not wind.

Mr. BACHUS. Okay. Ms. Williams, would you like to comment on that, or add anything?

Ms. WILLIAMS. My only comment is that we are looking at the gaps from having multiple policies, so that will be part of the final report, but ultimately, this issue is going to be resolved by the courts.

Mr. BACHUS. Thank you.

Chairman WATT. The gentlelady from New York, Ms. Clarke, a member of the Homeland Security Committee, is recognized for 5 minutes.

Ms. CLARKE. Thank you very much, Mr. Chairman. And I want to thank both Mr. Jadacki and Ms. Williams for coming and sharing your insights with us.

Since 1968, millions of Americans have depended on the National Flood Insurance Program to help them resume normal lives after the tragedy of a disaster. However, Hurricane Katrina and Hurri-

cane Rita exposed problems with the system that have greatly retarded the recovery of many families still attempting to regain their footing nearly 2 years after the disasters.

It is my hope that these reports will bring much-needed change to the NFIP, including the way it conducts oversight, and the way that it coordinates private insurance issuers.

I'd like to ask you, Mr. Jadacki, FEMA has told committee staff that even when overwhelming evidence comes out that a home was destroyed by wind, and thus should have been covered by private homeowners policies, it will not attempt to recover a Federal flood insurance payment made by the WYO company that adjusted the flood claim and that holds the wind policy.

Do you agree with this policy, and can you see any reason why FEMA should not try to recoup this payment?

Mr. JADACKI. I believe that FEMA, if there's evidence—I believe that if there's evidence of several different perils, then I think it should be correctly allocated among those perils.

It's difficult, because people evacuate and nobody was there, it's difficult to determine, but based on some engineering reports reviewed, based on some of the file evidence that we've seen from flood files, I think determinations can be made.

It may not be an exact science, but I think determinations can be made, and I think that what needs to happen is that the correct allocation between wind and water needs to be made.

Ms. CLARKE. And who would be ultimately responsible for making sure that is done?

Mr. JADACKI. Well, it depends on who has the insurance.

If the same Write-Your-Own company writes the flood insurance as well as the homeowner insurance, under the current process, it would be up to that insurance company to allocate that amount between flood and wind.

If there is a different insurance company or the insured has taken a flood insurance program directly from the National Flood Insurance Program, which a small portion do, then that coordination clause I talked about earlier would have to come into effect where they have to actually sit down and get together and discuss what the correct allocation is going to be.

Ms. CLARKE. So you are in favor of a coordination clause?

Mr. JADACKI. Absolutely.

Ms. CLARKE. Ms. Williams, I understand that GAO feels that FEMA does not reinspect a valid number of sample claims in conducting oversight. In your estimation, how short does FEMA fall, and does it have the resources to check adequate amounts to conduct the oversight?

Ms. WILLIAMS. In terms of choosing the sample, FEMA's approach is to go in and pull certain files based on certain characteristics. GAO's recommendation is for FEMA to actually do a random sample so that they would be able to project the results to the universe. It's unclear if it would actually involve FEMA having to pull more files. It's just the methodology used to select the files to review.

Ms. CLARKE. And so are you suggesting that there is a much more effective and efficient way of going about doing this; is that your finding?

Ms. WILLIAMS. GAO's position is that there is a more efficient way. I think what Katrina illustrated is that you are talking about a huge increase in the volume of claims that were actually processed, so if you are going to pull a random sample then, in years when you're dealing with a catastrophe like a Katrina, it would involve sampling a higher volume of claims. But yes, we do think a random sample would be more efficient.

Ms. CLARKE. Thank you very much, Mr. Chairman. Thank you, witnesses.

Chairman WATT. I thank the gentlelady.

The gentleman from Louisiana, Mr. Jindal, a member of the Homeland Security Committee.

Mr. JINDAL. Thank you, Mr. Chairman.

I have two questions. I'll go ahead and ask both of them, to give Ms. Williams the chance to answer both.

The first is that, immediately after Hurricane Katrina, the NFIP was, I think, appropriately lauded for trying to streamline its claims handling process so it could get claims checks in the hands of policyholders more quickly.

This effort was greatly appreciated by policyholders throughout the Gulf Coast, who were desperate to rebuild. This process involved new procedures that allowed adjusters to rely on satellite photos to determine a property's flood damage.

However, I don't think the process should have been streamlined at the expense of the integrity of the program or to jeopardize the taxpayers' interest.

My first question is, in your opinion, is the adoption of the GAO's October 2005 recommendations that the NFIP select claims to be reinspected from a random sample of all closed claims, is that enough of a safeguard to allow the NFIP in the future to use an expedited claims process during another hurricane season if it becomes necessary?

The second question is, and again I'll give you both of them, there have been several examples after the storms where the NFIP's lack of oversight allowed the insurance companies, or may have allowed the insurance companies to deny coverage to their own policyholders unless they could definitively prove the damage was caused by wind. One example, on the West Bank in Jefferson Parish, an insurance company paid $51,000 for 8 inches of water inside the home. The flood estimate, however, included costs that probably weren't caused by flooding, such as $7,000 for roof damage, $18,000 for exterior finish, and $20,000 for framing. The same policyholder only got less than $6,000 for wind coverage.

As I'm sure you're aware, the branch consultants, former insurance adjusters, have inspected, reinspected 150 properties with both wind and flood damage. They actually think this particular homeowner may have suffered $95,000 of wind damage.

I have a lengthier question. I guess my bottom line is, has the GAO undertaken a study or developed or analyzed safeguards that could be used to prevent insurers from shifting what is appropriately wind damage and classifying it as water damage?

I'll ask you to answer both of these questions in either order.

Ms. WILLIAMS. Okay. In terms of sampling, is implementing our recommendation about sampling going to be enough, it will be a start.

We are in the process of continuing to look at this issue and we do think that there are probably additional safeguards that will also need to be built into the program. Katrina really did change everything in terms of the level of internal controls needed and oversight required.

Once the NFIP had to go to the Treasury to borrow the funds it borrowed, and given its unlikely ability to repay those, it elevates the level of oversight required. So we will be looking at this issue and we hope to have recommendations beyond sampling methodology.

In terms of the second question, I think it ties into that. This is something that we're looking at, and we do expect to have recommendations in our final report.

Mr. JINDAL. In conclusion, I certainly want to applaud both witnesses. Thank you for your work.

I mean, certainly I think we've covered a very important topic today about how do we safeguard taxpayers' funding, and I would encourage you to continue.

We have to find the right balance. We don't want to see taxpayers' dollars wasted. At the same time, we want to make sure, God forbid, if there's another large catastrophe, we do have a way to expedite getting help to policyholders.

Thank you. Thank you, Mr. Chairman.

Chairman WATT. Thank you.

The gentleman from Mississippi, Mr. Taylor, is recognized now, with the previously approved unanimous consent request, for 5 minutes.

Mr. TAYLOR. Thank you, Mr. Chairman. I do want to thank our witnesses for being here.

I am troubled, Mr. Jadacki, that your Agency took so long to start looking into this. I mean, by the second week of September, checks for hundreds of thousands of dollars were being drawn on the Treasury. The cumulative effect of that is in the billions of dollars. But to the best of my knowledge, by June of 2006, your Agency wasn't looking into whether this was handled properly.

I, with the help of Chairman Oxley and Chairman Frank, was able to pass language through the House that said it ought to be looked into. By July of 2006, Senator Lott put an amendment on an appropriations bill for $3 million for this to be looked into. And quite frankly , I'm not so sure we have gotten our $3 million worth.

I would like to ask, have you taken the time to look at the meeting that occurred on September 7, 2005, where apparently Director Maurstad sat down with hundreds of representatives from the insurance industry and outlined how this was to have been handled, and included in that a statement where he says he had already been in touch with the heads of the major insurance agencies. Is there a written record of this meeting anywhere, and have you seen it?

Mr. JADACKI. No, we have not seen a written record of that meeting. We've seen guidance that was issued around the same time by Dave Maurstad, but we haven't seen any record of that meeting.

Mr. TAYLOR. The reason I ask this is, you know, there's a part of me that wonders if quite possibly Mr. Maurstad did not misspeak, and the reason that no one in Homeland Security was looking to see if we were paying bills we shouldn't have is because someone made a commitment, at the very top level of our Nation, that he shouldn't have made.

The second thing—and again, I'm trying to be fair with you, because I think you've been fair. I did notice that you mentioned that you have questions about the Write-Your-Own and that you admitted that there were 4 hours, up to 4 and 5 hours of wind before the water ever got there, and I'm sure in your capacity you understand then that at the end of 4 hours of hurricane winds, if a single two-by-four was still standing on a house, as far as the homeowner policy was concerned, if a wave knocked down that last two-by-four, that becomes a concurrent causation which means they're not going to pay anything on the homeowner's policy. On the flip side, it means that our Nation paid everything, when we should have just been paying for a two-by-four.

And so going back to 44 CFR 62.23, the entire responsibility for providing a proper adjustment for both combined wind and water claims and the flood alone claims is the responsibility of the national Write-Your-Own company.

Going back to the CFR, I'm a bit confused that when you asked the companies to justify having the taxpayer pay the whole bill rather than the wind paying some of that, that they weren't willing to provide more evidence.

That doesn't sound to me like a fair adjustment of the claim. It sounds to me like they're trying to hide something.

And I would welcome your comments on that, because again, I do appreciate your looking into this. I think you're kind of late. Quite frankly, I will use my own slab as an example.

Mr. JADACKI. Right.

Mr. TAYLOR. By the time you started looking into this, most of the lots in South Mississippi had already been cleaned. Most of the evidence had been destroyed.

I would have had a great deal more confidence that our Nation was doing a fair keeping of its own books if these investigations had been taking place when the snapped trees were still standing there, when partial houses were still there.

I wonder how good an investigation you could have done?

Mr. JADACKI. Right.

Mr. TAYLOR. The last thing I'd like you to comment on is that I've noticed there are actually more employees of Computer Science Corporation working for the National Flood Insurance Program than national flood insurance employees.

Did anyone ever look to see if Computer Science Corporation also has contracts with State Farm, Allstate, or Nationwide? Are there additional conflicts of interest on top of the ones that we already are aware of today?

Mr. JADACKI. Let me start with, our focus initially after Hurricane Katrina was on FEMA and some of the problems that FEMA was having in the Gulf area.

We focused mostly—and I'm not using it as an excuse, I'm just telling you where the initial focus of the IG was, being on the

ground with the individual assistance program, the housing, some of the things that we all have read about, we all are aware of.

We really didn't get any early indications that this was going on with the flood insurance program. We were aware of some of the issues that were going on with guidance going out to the different flood insurance programs.

There was guidance that went out in September by FEMA that basically attributed or suggested that the storm surge was the primary cause of damage in the Gulf area, and I think based on that, based on a review of the flood claim files, that the insurance companies hung their hat on that, that guidance that was out there, and that the normal traditional type of adjudication procedures, going out, looking at, checking, you know, looking at various patterns on the ground, were ignored because the insurance companies had the option of looking at a picture from space, a satellite view, or based on square footage of a residence or a home or a structure, they can adjudicate the claim based on that.

In some cases, the adjusters never even had to show up at a property, and were paid by FEMA, you know, depending on how they did it. So, you know, I think the door was opened when this guidance came out, saying it's storm surge, and that's going to be it.

I think in a lot of cases, the wind never came into play, and I think a lot of the lawsuits that resulted questioned that, and I think because of that, a lot of these lawsuits are being settled. But I think that's what happened back early on.

Mr. TAYLOR. I'm curious—if I may, Mr. Chairman.

Chairman WATT. I ask unanimous consent for 3 additional minutes for the gentleman.

Mr. TAYLOR. My memory is certainly not perfect, but I know that in the fall of 2005, additional funds had to be appropriated through emergency supplementals to keep the National Flood Insurance Program from issuing worthless checks.

So people had to know that the claims, I mean, going to the, again, the first, second week of September of 2005, it was common knowledge throughout our Nation that an enormous number of claims were being filed on the Federal flood insurance program that were going to add up to billions of dollars.

Again, I ask the question, didn't anyone in the Inspector General's office of Homeland Security, which has the overall responsibility for this, wasn't there anyone who was asking the question, "Are we paying bills that we ought to be paying or are we getting stuck with bills that we shouldn't be paying?"

I'll just use an example: If I were to sell a $150,000 boat to the Department of Homeland Security, I have to believe that somebody would come out and make sure that a boat was actually delivered. But the National Flood Insurance Program was writing $150,000, $200,000 checks on a daily basis—

Mr. JADACKI. Right.

Mr. TAYLOR.—that no one apparently was taking the time to see if it was a valid claim.

And what I find particularly troubling, since our Nation has spent $3 million for your study, is that there are articles dated May 31st that say claims were paid where there was no flood dam-

age, $95,000, in the Times Picayune; May 20th, where it says a family was paid—that Allstate filed a $135,000 claim on contents to a home when the family only asked for $38,000, so apparently they got $100,000 of taxpayer money that the family didn't even ask for.

Another article from May 20th, which outlines in just one instance with one family where the private insurance company was paying 76 cents per square foot to have sheetrock replaced, flood insurance was billed $3.31. Private sector insurance was paying $23.48 for carpet to be replaced in the exact same home upstairs, where downstairs they were paying $28.43 where it was attributed to flood. Paint upstairs, where they said the wind did it, 80 cents a square foot. Downstairs, where they said the flood did it, $1.15.

I mean, if the Times Picayune can find this, I have to believe that the Department of Homeland Security ought to be able to find this.

Mr. JADACKI. Right. And that's one of the things, as I mentioned in my written testimony, that we will be looking at, prices for like kind types of things, things like drywall, things—replacement for carpet, and those types of things, to see if in fact that the flood insurance, as indicated in the newspaper articles, was paying 3 or 4 times more than what the private sector insurance companies would pay.

Right now, we don't have access to that information, but once we get that, we're going to corroborate, because we have the pricing lists, in most cases, for the flood insurance claims that were paid, and if there's evidence of a wind claim payment, there should be a pricing list on that, too, and we'll be able to identify those discrepancies.

We've also had several meetings with the FEMA folks, based on those articles, and forwarded it to them, and said, "Please explain how this can happen," and we have yet to hear back from them about the explanation of that, the various pricing levels, and also the cases where there is no apparent flooding in New Orleans, but yet the structures received significant amounts of flood insurance damage.

Mr. TAYLOR. Do you need any additional legal authority to conduct your study?

Mr. JADACKI. We believe we really don't have oversight over the private sector insurance companies.

If by law we can get that authority, that would certainly help our case, but I think it would help more if the National Flood Insurance Program, the authorities that they would have, which would require that if there are indications where there's joint payments, that there would be evidence in the flood file to show that. I think that would go a long way.

Quite frankly, we were caught off guard when we reviewed a lot of claims filed, because we thought for sure there would be evidence in there, and basically, there's a box that says, "You got flooded and it's going to be a flood claim," and in very limited instances, unless you look at a picture, was there anything explaining that, yes, part of the structure is going to be paid through the flood insurance program and this part is going to be paid from the wind claims.

We actually looked, we looked for roofs disappearing, we looked for contents that were paid on a second-story floor when there are 8 or 12 inches of, you know, water in there, but we just could not tell from the flood files what was being paid and whether it was fair and equitable based on both wind and water. It just wasn't there.

Mr. TAYLOR. So under existing law, if State Farm says $200,000 worth of damage, water did it all—

Mr. JADACKI. Right.

Mr. TAYLOR.—you have no legal authority to question that, you just issue a check?

Mr. JADACKI. That's the way it works. If there's evidence supporting the $200,000 that was all caused by flood, that's fine. That's the way the process works.

But if there is another $150,000 of damage because of wind, there's no evidence right now in the flood files that would indicate that was the case, nor is there any evidence saying a $200,000 payment, $100,000 is attributable to flood, and $100,000 is going to be attributable to wind. There's nothing in the files that would indicate that.

Mr. TAYLOR. Thank you, Mr. Chairman.

Chairman WATT. I thank the gentleman.

Let me just do a couple of things.

First of all, I ask unanimous consent that the newspaper articles that you've made reference to be made a part of the record, and if you would make sure we get a copy of them, we'll put them in the record so that all of the members of the two subcommittees will have access to that information.

Second, I would like to advise the gentleman that quite possibly at some point in the very near future, we'll be coming face-to-face as a committee with the same dilemma that the Inspector General is in now, because the committee, the subcommittee has made a request under its investigation authority for a number of documents, which request is to be complied with by June 14th, so you have about 2 or 3 more days to find out whether the private carriers will be willing to provide information to the committee about this, and then we'll make some assessment of what the consequences are if we don't get the information.

So that might be giving the Inspector General more authority, it might be taking more authority ourselves. We'll have to assess that.

But I want the gentleman to at least know that is coming right down the pike, because preliminarily, a number of the insurance companies have made some sounds about the prospect that they will object to providing certain information to the subcommittee that would allow us to make an evaluation. So we're trying to figure out where that will come out as of the 14th of June.

Now, with the ranking member's permission, let me just ask two additional questions.

First of all, can we get some reasonable, your best estimates of when you believe your final reports will be out based on what you know now?

I'm not trying to hold you to that, because I know that you have some obstacles that you're dealing with, but your best estimate

that you're able to give at this moment, of when your final reports will be out.

Ms. Williams and Mr. Jadacki.

Ms. WILLIAMS. We're hoping October.

Chairman WATT. Of 2008?

Ms. WILLIAMS. Of this year.

Chairman WATT. 2007?

Ms. WILLIAMS. Yes, of 2007.

Chairman WATT. Oh, okay. I didn't want to give you an extra year.

Mr. Jadacki?

Mr. JADACKI. Okay. We, like I mentioned earlier, we plan to issue an interim report in the next couple of weeks, just based on the work of the flood insurance program.

I'll say within the next 30 to 60 days, we will probably get our final report out.

The missing link is again getting the records from the insurance companies and matching them up. We've done tons of work in the flood area. We just need to corroborate some of the statements, some of the records, some of the file information that we got with the records from the insurance companies.

Chairman WATT. And finally, from my perspective, I'll give the ranking member and any other members who want to ask one or two additional questions that opportunity, but will the scope of your report, if you find that there were improper allocations between flood insurance and private insurance, will the scope of your report detail those and provide suggestions about what recourse is available to FEMA and/or the other Departments of the Federal Government to redress those improper allocations?

Ms. WILLIAMS. Our report will focus on the oversight component of it, because we don't have the information that the IG is going to be getting. We aren't going to be in a position to identify specific cases. That will most likely be left to the IG. So we will be looking at the broader oversight issue.

Chairman WATT. Mr. Jadacki, I think the ball has been punted to you.

Mr. JADACKI. That's fine. Thank you very much. If there are any indications that there were misallocations, we will certainly highlight those. If there are indications that it is as a result of a fraud or some sort of bigger scheme, we would have to probably consult with the Department of Justice, U.S. Attorney's Office, who would most likely be handling those cases.

So there are certain things, as you all know, that are ongoing, you know, investigations. We may not report those things.

It all depends on what we find in those files. Again, if it's just a simple misallocation or some formula that wasn't used correctly, yes, we'll probably talk about those types of things, and if we have to, we can talk in general terms, but certainly, yes, if we find any indications, we will be reporting those, because it is a concern of ours as a control problem, too.

Chairman WATT. Does the ranking member have any additional questions?

Mr. MILLER. My comment to the IG on the part of it being a complete report, I'm concerned that you have an adequate amount of

time to prepare a complete report rather than just being rapid in your response to us.

I would rather see, if you find information that's coming to you that you think needs further investigation, that you just keep us abreast of that, and let us know what's going on—I'm speaking for myself—so when you're through, we have something that we can actually look at and that we feel is complete and we can act upon.

Chairman WATT. If the gentleman will yield just briefly, I would say exactly the same thing from the Chair's perspective.

My question was not designed to put pressure on you to produce a speedy, incomplete report. It was just to get some estimate, or your best estimate at this point of when you projected that was coming. I fully concur with the ranking member that I would rather have a thorough, complete report than a quick, incomplete report.

So I yield back to the gentleman.

Mr. MILLER. I'm just concerned that, you know, you're doing an investigation right now, and if information comes to you and becomes relevant, you might have to expand your investigation.

I don't know. Maybe you'll get the information, it's adequate, and you can prepare it in a, you know, rapid amount of time, but I would just emphasize that I think we're both looking for something that's adequate and complete.

I yield back.

Chairman WATT. Does the gentlelady from New York wish to be recognized again?

In that case, the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record, and we would ask the witnesses to respond as expeditiously as possible if that occurs.

I believe that completes the hearing, and consequently, this hearing is adjourned.

[Whereupon, at 4:55 p.m., the hearing was adjourned.]

A P P E N D I X

June 12, 2007

Statement of Ranking Republican Gary G. Miller
Joint Hearing
Financial Services Subcommittee on Oversight and Investigations
Homeland Security Subcommittee on Management, Investigations, and Oversight

Hearing On:
"National Flood Insurance Program: Issues Exposed by the 2005 Hurricanes."

June 12, 2007

I commend Chairman Watt for convening the second in a series of hearings on the question of how our insurance system performed in fulfilling its obligations in the aftermath of the 2005 hurricanes. These hearings are critical as the Committee considers changes or improvements to our current insurance system, both for the National Flood Insurance Program and for the regulation of private insurance. I welcome our colleagues from the Homeland Security Subcommittee on Management, Investigations, and Oversight who have joined us for this important hearing.

The focus of today's hearing is on the flood insurance payments made by the National Flood Insurance Program (NFIP) following the 2005 hurricanes. I am pleased to welcome Mr. Jadacki of the Department of Homeland Security Inspector General's Office and Ms. Orice Williams from the U.S. Government Accountability Office to discuss with us their preliminary findings about how appropriate the National Flood Insurance Program payments were for the flood losses incurred during the 2005 hurricanes and to assess the ability of FEMA to ensure claims paid by the NFIP are handled appropriately.

Unprecedented NFIP Payments Made After 2005 Hurricanes

There is no question that the 2005 hurricane season resulted in significant strains on the NFIP. The claims resulting from the losses from these catastrophic hurricanes are unprecedented in the history of the program.

To put this into perspective, since the NFIP's inception in 1968 and until the 2005 hurricane season, the program paid out $15 billion in claims. In contrast, the NFIP incurred liabilities estimated to total at least $23 billion as a result of the 2005 Gulf Coast hurricanes. This significantly exceeds the $2.2 billion in premiums earned annually and surpasses claims paid in the entire history of the NFIP by $8 billion.

In the past, when losses exceed premiums, the NFIP has been allowed to borrow from the U.S. Treasury to repay claims. Such loans have traditionally been paid back rather quickly, with interest. In order to pay claims for 2005 hurricanes, the NFIP was forced to borrow $17.6 billion from the Treasury, an amount it estimates it will never be able to repay.

Strong Oversight of NFIP Payments Necessary to Protect Taxpayers

Obviously, with almost $18 billion in flood claims being paid by the Treasury rather than the flood program itself, we must ensure that taxpayers are not footing the bill for inappropriate claims adjustments.

Some have alleged that insurers shifted wind claims to the flood program so that they could pay less for the wind portion of the hurricane loss.

If this is true, it is an outrage that should be rectified immediately. And those engaged in such fraud should be strongly punished.

Particularly in cases where a property is damaged by both flooding and wind, strong oversight must be in place for the National Flood Insurance Program to ensure it does not pay out more than it should.

This is a difficult prospect - Flood and wind damage are supposed to be assessed separately, but in some cases they occur simultaneously.

At our first hearing on this subject, we heard from the Mitigation Division Director and Federal Insurance Administrator for the Federal Emergency Management Agency, David Maurstad, who testified that the NFIP only paid for the damage associated with flood and only up to the coverage limit.

According to Maurstad, there is a rigorous program of oversight in place to ensure the NFIP program only pays for damages caused by flooding.

Maurstad testified that no claims from the 2005 hurricanes have come to his attention that should not have been paid at the level they were paid.

According to Maurstad, the NFIP does not determine damage caused by perils other than flood or storm surge.

He said the NFIP does not differentiate damage that could be covered elsewhere – if damage is caused by flooding, then it is compensated as such under the NFIP.

This raises two questions that we as policymakers must answer:

1.) If the NFIP is not looking at damage from other perils, can we be sure the flood claim is accurate?

2.) Should the NFIP still pay for damage that is found to be also covered by a separate private insurance claim?

Looking Back and Moving Forward – The Importance of Strong Oversight

Looking Back

I look forward to hearing from the witnesses today, who have been given the difficult task of assessing whether FEMA has taken adequate steps to ensure the NFIP's flood claims payments are accurate and appropriate.

As I said previously, this subcommittee was assured by FEMA at the last hearing that controls are in place to be sure the NFIP does not pay out more than is required under the terms of a flood policy.

Today, we have the opportunity to hear the opinions of two independent sources about whether they agree with FEMA's assessment about its oversight processes and its ability to ensure the accurate payment of claims.

If the NFIP paid more than it should have after the 2005 hurricanes because insurance companies pushed wind losses to the flood program rather than paying for them under homeowners policies, then we must hold those companies accountable.

But let me just say, that there is a difference between the potential for wrongdoing and a finding of actual wrongdoing.

This is an important distinction as we proceed today.

I have reviewed the written statements of the witnesses today and understand that misbehavior on the part of the insurance companies that write both flood and wind policies for their customers can not be ruled out at this point in either investigation.

They just haven't completed their review yet.

Let us not prejudge the findings of this important investigation or vilify the entire insurance industry for claims shifting without concrete evidence to prove such allegations of widespread wrongdoing.

Moving Forward

This hearing is very timely, as just this morning the Housing Subcommittee held a legislative hearing on H.R. 1682, the Flood Insurance Reform and Modernization Act of 2007, legislation to make improvements to the NFIP.

Obviously, if we learn from the witnesses today that the oversight controls that are in place are not adequate, then we have the opportunity through H.R. 1682 to make changes to these processes.

This will help protect taxpayers moving forward.

We must eliminate potential conflicts of interest so that the NFIP operates in the most efficient and effective manner.

I do not believe anyone would argue against the importance of strong oversight.

Conclusion

In conclusion, I think we need to proceed cautiously today.

We have all seen the anecdotal news reports and heard stories from our colleagues from the region about practices by some insurance companies that, if true, are very disturbing and must be addressed.

I am also aware of examples of companies that used two separate adjusters for handling wind claims and water claims to avoid any potential for conflict as has been alleged. Such adjusters were kept separate – they did not communicate with one another and they utilized completely different claims systems.

Did insurance companies abuse the NFIP to protect their bottom lines?

Was such abuse widespread?

At this point we do not have the evidence to make a determination either way. We just don't know and need to allow GAO and the DHS-IG to complete their important work before rushing to judgment.

We need to take the preliminary findings of these reports at face value and for the purpose of moving forward with NFIP reform legislation.

We should use this hearing to ask important questions about ways to avoid potentials for abuse in the future.

For example, we should consider:

- How do we ensure "Write Your Own" (WYO) insurance companies do not have the ability to defraud the NFIP when a structure endures wind and flood damage?
- Is it best to require more coordination between flood and wind adjustments or is it best to require absolute separation between the claims, including requiring different claims adjusters?
- Should the existing NFIP claims adjustment procedures be revisited so as to ensure any potential conflicts of interest are eliminated?

Once the GAO and DHS-IG complete their important studies we will have a better sense whether and to what extent damages from the 2005 hurricanes were improperly attributed to flooding rather than wind.

STATEMENT FOR THE RECORD

MATT JADACKI
DEPUTY INSPECTOR GENERAL
FOR DISASTER ASSISTANCE OVERSIGHT

U.S. DEPARTMENT OF HOMELAND SECURITY

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

AND

COMMITTEE ON HOMELAND SECURITY
SUBCOMMITTEE ON MANAGEMENT, INVESTIGATIONS, AND OVERSIGHT

U.S. HOUSE OF REPRESENTATIVES

JUNE 12, 2007

Good afternoon, Chairman Watt, Chairman Carney and members of the Subcommittee.

My name is Matt Jadacki, I am the Deputy Inspector General for Disaster Assistance Oversight in the Office of Inspector General for the Department of Homeland Security (DHS). Thank you for the opportunity to be here.

This afternoon I will address issues regarding the National Flood Insurance Program (NFIP). In our review, we have concluded that the Federal Emergency Management Agency (FEMA) needs to increase oversight over damage claims that involve both wind and water on the same structure. Our limited review of the flood claims indicated that payouts on flood claims were timely and complied to NFIP terms. However, there is little evidence in flood claim files to determine whether flood payouts were fair and equitable for damages caused by both wind and water affecting the same structure.

Background

Hurricane Katrina made landfall on the Mississippi coast at 10:00 a.m. on August 29, 2005. For the coastal areas in Mississippi, estimates for wind gusts ranged from 70 to 121 miles per hour, and storm surge reached a maximum height of 28 feet. Property damage was caused both by the hurricane force winds and the storm surge flooding. The Department of Homeland Security Appropriations Act, 2007 (Public Law 109-295), directed the Department of Homeland Security, Office of Inspector General, to investigate whether, and to what extent, insurance companies under the Write-Your-Own (WYO) program improperly attributed damages from Hurricane Katrina to flooding covered under the NFIP rather than to windstorms covered under homeowner policies or wind insurance pools.

Homeowner insurance policies typically cover wind but not flood damage. WYOs are private sector insurance companies authorized by NFIP to sell flood insurance. WYOs have no financial exposure when damage is caused by flood because the federal government, through the NFIP, reimburses WYOs for claims they pay. Although the NFIP does not have direct control over the WYOs, the WYOs agree each year to terms and conditions with the FEMA on various compliance and business issues. This agreement provides, among other things, that WYOs will comply with written standards, procedures, and guidance issued by FEMA. For additional background on the NFIP, see Appendix A.

We reviewed a sample of flood claim files in three Mississippi counties. We examined adjuster's comments and calculations relating to damage caused by flood as well as other evidence in the claim files such as photographs and correspondence between the insured and WYO. We also analyzed legal opinions, reinspection reports, and NFIP complaint files. We interviewed officials from FEMA, insurance association representatives, insurance adjusters, WYO officials, and other experts. It is important to note that we did not have the same access to the WYOs' records of wind claims as we did to the flood

claims that are funded by the government. The wind claim files are a likely place to find indications that WYOs may have attributed wind damage to flooding. We have, however, issued administrative subpoenas for those records. We plan to issue an interim report to inform Congress and FEMA of our findings to date. Further details on the scope of our review are included as Appendix B.

Was Wind Damage Attributed to Flooding?

Storm surge (flooding) was the primary cause of damages sustained along the Mississippi coast, but high wind velocity before the surges in water also caused damage. The central question is whether WYO companies, in settling claims, may have improperly attributed damage caused by wind to flooding in order to avoid liability under the standard homeowner's policy. This question is especially relevant in situations where the same WYOs held both homeowner and flood policies for the same insured property. Following is a summary of our review of the flood claims:

- We reviewed 98 flood claim files to determine whether they contained any indication that wind damage might have been attributed to flooding. The NFIP provided us the flood files, but did not provide wind claim files, which are maintained separately by the WYOs. Several of the flood claim files contained references to, and photographic evidence of, wind damage; however, with the exception of two files, there was no information on how much wind damage occurred, the cost of the damage, or whether wind claims were filed. There was no indication that wind damage was attributed to flooding or that flood insurance paid for wind damage. Information on select attributes of the files reviewed is shown in Appendix C.

- We interviewed 20 flood adjusters who did some of the damage investigations for the properties in the files we reviewed to determine how they conducted their inspections. These adjusters were not involved in any wind damage assessments and felt they were not under pressure from WYOs to attribute wind damage to flooding. The process used by NFIP adjusters is described in Appendix D. They based their damage determinations on the physical evidence at the scene. Representatives from two associations representing the insurance industry were not aware of any instances of wind damage being attributed to flooding. Eleven representatives of the WYOs in our sample explained that they have plans to address catastrophic events such as Hurricane Katrina and that they base adjustments on physical evidence at the damaged property. In total loss cases where only a foundation (slab) remained, it was often difficult to determine whether wind or flood was the cause of damage. Several WYO representatives allocated a portion of the loss to wind by using an evaluation of damage to the neighborhood, engineering support, analysis of wind data, aerial photographs, interviews, analysis of debris, and extent of the damage to trees.

- We also met with FEMA General Adjusters and reviewed reinspection reports to determine whether they had identified indications that wind damage was attributed to flooding. Reinspections are conducted by a team of FEMA General Adjusters as a quality control step in the flood adjustment process. Adjusters reviewed a sample of flood claim files to determine whether the adjustments conform to NFIP standards. There were 599 reinspections performed on Hurricane Katrina flood claims in Mississippi, and we reviewed 135 of the reports. None of the reports contained evidence that wind damage had been attributed to flooding. See Appendix E for more information on the reinspection process.

- We interviewed 36 homeowners included in our sample of flood claims to determine whether they believed their insurance companies improperly attributed wind damage to flooding. Payments for wind damage were received by 32 of these homeowners. Four of the 36 did not have insurance that covered wind damage. The amounts received ranged from $630 to $500,000. In 29 cases, those receiving wind settlements told us they were satisfied with the amounts paid under their homeowner's policy. There were 7 homeowners who were not satisfied with the amount of settlement for wind. Some of the reasons for their lack of satisfaction include: (1) they did not feel they received payment for damages caused by rain leaking through damaged roofs; (2) payments did not reflect increased costs of labor and materials after the storm; and, (3) detached buildings were not covered.

- We reviewed NFIP appeals and complaints for assurance that there was no evidence indicating that WYOs attributed wind damage to flooding. Although one would not expect to find such complaints in flood claim files, we wanted to include all sources of information to which we had access. When policyholders had complaints about wind damage being attributed to flooding, they would most likely be documented in the WYOs' records of wind damage. There was only one appeal related to Hurricane Katrina. An appeal is a formal NFIP process where policyholders can seek a second review of their flood claim. There were 18 complaint letters filed with the NFIP. One included a complaint that the insurance company paid a flood claim, but denied a wind claim. NFIP responded that the flood claim was paid at policy limits and that the homeowner's frustration over the WYO's denial of wind coverage was not within the scope of the NFIP complaint handling process. Our review of complaints revealed that none had a relationship to the issue of whether the NFIP paid for damages caused by wind.

Complicating Factors When Wind and Flood Occur Together

Although nothing came to our attention during our limited review to indicate that WYOs attributed wind damage to flooding, we cannot rule out the possibility that it occurred. Flood adjusters were professional and based their determinations on the physical evidence they observed. However, there are several complicating factors that contribute to the perception that WYOs might have attributed wind damage to flooding.

- First, it may be difficult to distinguish between wind and flood damage when the two perils occur concurrently, and especially when there is nothing left of the property except a foundation (slab). WYO flood adjusters do not generally identify or quantify damages that may have been caused by wind. The NFIP Claims Adjusters Manual does not direct adjusters to document whether wind was also involved in damages to a structure. According to data available, winds played a role in damages to the Mississippi coast. For example, hurricane force winds were present up to 4 hours prior to the storm surge. Experts told us that such a differential could contribute toward significant damage caused by wind. Appendix F graphically shows the time difference and impact of winds and surge.

- Second, insurance policies are difficult to understand and often misunderstood. Most insurance contracts are drafted to exclude flood damage. A typical homeowner's insurance policy is a contract with no negotiation and few people read or understand its contents. The insurance industry is primarily regulated at the state level. Policy forms are reviewed and approved by state agencies. Homeowners' policies historically have excluded flood damage. As many in the Gulf Coast have learned, most homeowners' policies have standard flood exclusions effectively denying coverage no matter what caused the flood.

  Homeowners' policies normally contain language, which explicitly excludes flood damage, regardless of how the damage was caused. This provision is referred to as an "anti-concurrent causation" clause and these clauses have been standard in homeowner policies for decades. As with any catastrophic event, Hurricane Katrina has produced numerous lawsuits. One of the key issues raised in this private litigation between insurers and policyholders is the flood versus wind dispute – whether the standard homeowner's policy with an anti-concurrent causation clause will cover damage that resulted from Hurricane Katrina. Resolution of these cases will depend on extensive evidence of causation and interpretations of policy language. The following is a typical anti-concurrent causation clause for water damage:

  > *We do not insure for loss caused directly or indirectly by any of the following excluded events. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.*

These exclusions apply whether or not the loss event results in widespread damage or affects a substantial area.

Water damage, meaning:
Flood, surface water, waves, tidal water, tsunami, overflow of a body of water, or spray from any of these, all whether driven by wind or not.

This language preempts coverage when, for example, an otherwise covered peril, such as hurricane force winds, causes flooding, an excluded peril.

The Mississippi Attorney General filed suit on behalf of the state against several major insurers seeking a ruling that the insurers must pay flood damages because hurricane winds caused the flooding. The suit alleged that the policy exclusions are ambiguous and should therefore not be enforced. The suit also alleged unfair trade practices on the part of the insurers representing that policies provided comprehensive hurricane coverage.

- A third factor adding to a perception that wind damage was improperly attributed to flood is that adjusters are either working for WYOs or for companies hired by WYOs, and many people believe this creates a conflict of interest. The WYO has no financial exposure for flood damage, so some adjusters might favor finding flood damages rather than wind damage to reduce the WYO's financial exposure. Although nothing came to our attention to indicate that adjusters attributed wind damage to flooding, the appearance of a conflict persists.

- Finally, FEMA's oversight of the WYOs is limited. Under FEMA regulations, the entire responsibility for providing a proper adjustment for both combined wind and water claims and flood-alone claims is the responsibility of the WYO company. FEMA's agreement with the WYOs provides that claim adjustments shall be binding upon FEMA. FEMA needs to increase its oversight role of the WYOs and that increased oversight can be accomplished by amending its agreement with the WYOs to make better use of its two quality control functions. Reinspections permit FEMA to take another look at the adjusters' work; however, they focus exclusively on adjustment of the flood claim. They could be expanded to include wind damage information. FEMA also performs operational reviews of WYOs. These operational reviews focus on flood insurance claims, underwriting, customer service, marketing, and litigation activities. These reviews also could be broadened to include wind damage information. In addition, the NFIP Claims Adjusters Manual provides no guidance on ensuring that wind damage is not attributed to flooding. Expanding the scope of these quality control measures could help FEMA to ensure that the WYOs are not improperly attributing wind damage to flooding.

Conclusion

In conclusion, we determined that FEMA needs to increase oversight over damage claims that involve both wind and water on the same structure. Our limited review of the flood claims indicated that payouts on flood claims were timely and complied to NFIP terms. However, there is little evidence in flood claim files to determine whether payouts were fair and equitable for damages caused by both wind and water affecting the same structure. In addition, FEMA did not maintain documentation indicating the total damage to a structure and how much was attributable to flood and wind, nor is it required by the NFIP. As a result, NFIP oversight focused primarily on whether the flood claim was correctly adjudicated with little or no consideration for wind damage as a contributing factor. Under the current process, it is difficult to determine whether the NFIP paid a higher percentage or the entire damage claim involving both perils.

We recommend that the Administrator, Federal Emergency Management Agency:

1. Require Write Your Own Insurance Companies to document and make available to the NFIP the rationale and methodology for calculating flood and wind damage when there is evidence that both perils contributed to the damage, and revise the NFIP Claims Adjuster Manual to reflect these new requirements;
2. Expand the reinspection process to include a review of and determination that flood and wind damage on the same structure was settled in a fair and equitable manner to ensure that wind damage was not paid under the flood policy; and,
3. Provide clear and concise guidance for adjusting total loss claims after catastrophic events when structures are completely destroyed by wind and water.

As discussed above, we have issued administrative subpoenas for WYO insurance companies records providing both wind and flood coverage. We plan to corroborate the documentation and assertions made in our review to determine whether and to what extent damages were improperly attributed to flooding rather than wind. We also plan to determine whether unit pricing for like materials paid under flood and wind claims were consistent and reasonable. We will issue our final report upon our completion of our wind claim analysis.

Chairman Watt, Chairman Carney, this concludes my prepared statement.

I will be pleased to answer any questions you or Members of the Subcommittee may have.

Appendix A

Overview of NFIP

The National Insurance Act of 1968 mandated the creation of a National Flood Insurance Program. There had been attempts at passing similar legislation since the 1950s; however, the destruction brought about by Hurricane Betsy in 1965 provided the momentum for Congress to make it a reality. Prior to 1968, relief for people affected by flood was limited to disaster assistance.

NFIP enables property owners in participating communities to purchase flood insurance in exchange for state and local floodplain management to reduce future flood damages.

The National Insurance Act of 1968 prescribes three main objectives to be accomplished by the NFIP:

- Provide affordable flood insurance to qualified homeowners,
- Reduce flood damages through floodplain management regulations, and
- Identify and map the Nation's floodplains.

The Act also establishes two categories of properties:

- Pre-FIRM (Flood Insurance Rate Map): Buildings constructed prior to the initial flood map for the community. These buildings are entitled to subsidized flood insurance rates, as long as the communities where they are located comply with floodplain management regulations.
- Post-FIRM: Buildings constructed (or substantially improved) after the initial flood map for the community, or after December 31, 1974, whichever is later. The Act mandates that full actuarial rates, reflecting the true flood risk, be charged on these structures.

In creating the NFIP, Congress found that a large flood insurance program with "*large scale participation of the Federal Government, and carried out to the maximum extent practicable by the private insurance industry, is feasible and can be initiated.*" In keeping with this purpose, FEMA has contractual arrangements with 95 private insurance companies to sell policies and adjust and process claims, in what is called the "Write-Your-Own" (WYO) program, to differentiate it from the "NFIP Direct" program, or policies written directly by the NFIP. Approximately 97 percent of flood policies are written by WYOs.

In view of limited participation in the program, in 1973 Congress passed the Flood Disaster Protection Act, which strengthened NFIP's outreach efforts by:

- Restricting federal aid in non-participating flood prone communities.

Appendix A

- Introducing the Mandatory Flood Insurance Purchase Requirement, that mandated lenders require evidence of flood insurance in areas deemed to be flood hazard areas.

In 1994, Congress amended the 1968 and the 1973 Acts via the National Flood Insurance Reform Act, requiring, among other things:

- Increased compliance by mortgage lenders with the mandatory purchase requirement,
- Increased flood coverage amounts, and
- Updates to flood maps every 5 years.

In 2004, Congress enacted the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, which required, among other things:

- A 5-year pilot program to deal with repetitive loss properties, including federal funding for the purchase of "severe repetitive loss properties."
- Establishment of regulatory appeals process for claimants.

Appendix B

Purpose, Scope, and Methodology

The Department of Homeland Security Appropriations Act, 2007 (Public Law 109-295), directed the Department of Homeland Security, Office of Inspector General, to investigate whether, and to what extent, insurance companies under the WYO program pursuant to section 1345 of the National Flood Insurance Act of 1968 (42 U.S.C. 4081) and subpart C of part 62 of title 44, Code of Federal Regulations, improperly attributed damages from Hurricane Katrina to flooding covered under the National Flood Insurance Program (NFIP) rather than to windstorms covered under homeowner policies or wind insurance pools.

Specifically, our review objective was to determine whether NFIP records contained evidence of WYO companies attributing wind damage to flooding.

We interviewed FEMA and NFIP Bureau and Statistical Agent personnel, as well as experts in the field of wind and flood damage assessment. In addition, we interviewed 20 adjusters and 11 officials from the 12 WYOs in our sample of claims, and representatives from two insurance associations. We interviewed 36 homeowners to determine whether they received wind settlements and their satisfaction with the amount received. We limited our review to flood insurance claims paid through NFIP, since we do not have the same access to wind claims under homeowner policies written by private insurers as we do to NFIP flood claim files. However, we have issued administrative subpoenas to the insurance companies in our sample to receive wind claim files. We selected a judgmental sample of 100 flood insurance claim files from the 3 coastal counties in Mississippi – Hancock, Harrison, and Jackson – because the wind versus flood issue was most prevalent in that area. The sample consisted of flood claims in areas of high surges and low surges, with some settlements paid at the policy limits and some other settlements paid at less than the policy limits.

We conducted fieldwork in Washington, DC; at the NFIP Bureau and Statistical Agent facilities in Lanham, Maryland; in Mississippi; and at Clemson University in South Carolina. We conducted our audit from December 2006 to May 2007 under the authority of the Inspector General Act of 1978, as amended.

Appendix C

Attributes of Claim Files Reviewed		
	Number of Sample	Percentage of Sample*
Wind Damage Paid by NFIP	0	0%
Primary Residence	77	78.6%
Paid at Policy Limit	69	70.4%
Foundation (slab) Only	33	33.7%
Reinspected by NFIP	4	4.1%

*Based on reviewing 98/100 claims. Two files were not provided due to pending litigation.

Building Attributes		
	Number of Sample	Percent of Sample
Pre-FIRM*	75	76.5%
Post-FIRM*	23	23.5%
Total	98	100.0%
Number of Stories*		
1	68	69.4%
1.5	3	3.1%
2	27	27.5%
Total	98	100%
Age of Property*		
0 - 10 years	21	21.4%
11 - 20 years	12	12.2%
21 - 30 years	9	9.2%
31 - 40 years	28	28.6%
41 - 50 years	12	12.3%
Over 50 years	16	16.3%
Total	98	100%

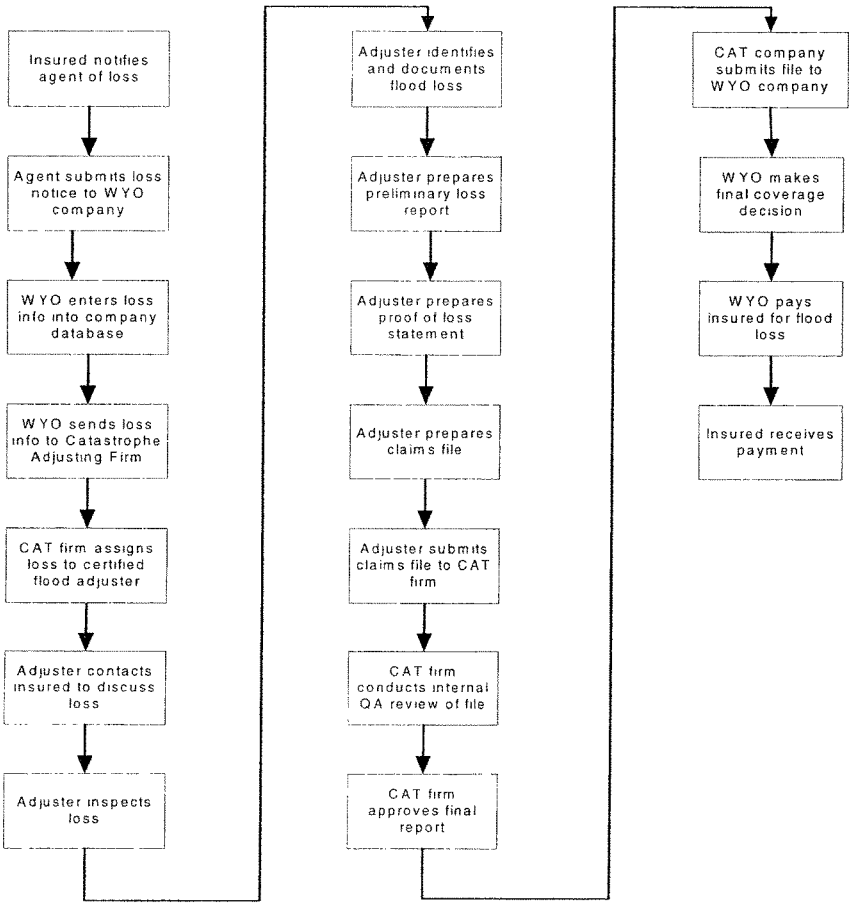
*Based on reviewing 98/100 claims. Two files were not provided due to pending litigation.

Appendix D

NFIP Claims Adjustment Process

NFIP uses federal employees, contractors, and private sector organizations to process flood claims. Contractors and private sector organizations consist of insurance carriers, flood claims processing companies, catastrophe adjusting firms (CAT), and information technology management companies that support core NFIP databases and systems.

The following flowchart highlights the key activities involved in a standard NFIP flood claim adjustment process.



Appendix D

A reason for using a standard process is to ensure that similar loss scenarios are assessed and adjusted similarly by different adjusters, regardless of experience, capabilities, or company affiliation. Flood adjusters are required to be certified by the NFIP, but this requirement is waived in the case of adjusters employed directly by one of the flood insurance carriers. FEMA requires that uncertified adjusters receive appropriate supervision and direction from certified or more experienced adjusters.

Appendix E

NFIP Reinspection Process

As part of our evaluation of the NFIP claims adjustment process, we reviewed a sample of reinspections performed on Hurricane Katrina-related flood claims in the state of Mississippi. The primary purpose of this review was to determine whether any of the reinspections identified situations where wind damages were attributed to flooding.

NFIP uses a claims adjustment reinspection process ("reinspection") to review a judgmentally selected sample of claims adjustments after each flood event. The purpose of this reinspection is to determine whether the adjustment process conformed to NFIP standards and guidelines. It is also used to identify cases of over- or underpayments of damage settlements or fees. The review is conducted by experienced claims adjusters (General Adjusters) employed by NFIP's Bureau and Statistical Agent.

Reinspections are selected in two ways. First, NFIP conducts routine reinspections of a judgmentally selected sample of claims adjustments on an ongoing basis. Special request reinspections are also conducted in the event of an appeal or formal complaint of an adjustment, or in any case when more information is needed regarding a specific adjustment.

According to the reinspection database maintained by the NFIP's Bureau and Statistical Agent, 599 reinspections were performed on Hurricane Katrina-related flood claim adjustments in Mississippi. Reinspection documentation includes a reinspection report, a detailed itemization of the results of the reinspection against a standard NFIP reinspection checklist, and comments from the General Adjuster who performed the reinspection.

Appendix F

Overview of Meteorological Data

The graphs shown on the following pages are the product of a computer simulation by WorldWinds, Inc., using data gathered from FEMA, National Oceanic and Atmospheric Administration's National Weather Service, U.S. Geological Service, National Aeronautics and Space Administration, U.S. Army Corps of Engineers, as well as other sources.

These graphs demonstrate, for specific coordinates, that winds reached speeds between 90 and 110 mph prior to maximum water surge in Hancock, Harrison, and Jackson Counties. The high winds preceding the flooding indicate that there was damage to structures from both wind and flooding. The Saffir-Simpson Hurricane Scale estimates potential property damage and flooding expected along the coast from hurricane landfall. Wind speed is the determining factor in the scale. Below are summaries of the estimated damages to property based on the following hurricane categories:

- **Category One Hurricane**: Winds of 74-95 mph. Storm surge is generally 4-5 feet above normal. No damage to building structures. Damage primarily to shrubbery, trees, and unanchored mobile homes.

- **Category Two Hurricane**: Winds 96-110 mph. Storm surge is generally 6-8 feet above normal. There is some roofing material, door, and window damage to buildings. Considerable damage to shrubbery and trees with some trees blown down. Considerable damage to mobile homes, poorly constructed signs, and piers.

- **Category Three Hurricane**: Winds of 111-130 mph. Storm surge is generally 9-12 feet above normal. Some structural damage to small residences and utility buildings. Damage to shrubbery and trees with foliage blown off and large trees blown down. Mobile homes and poorly constructed signs are destroyed.

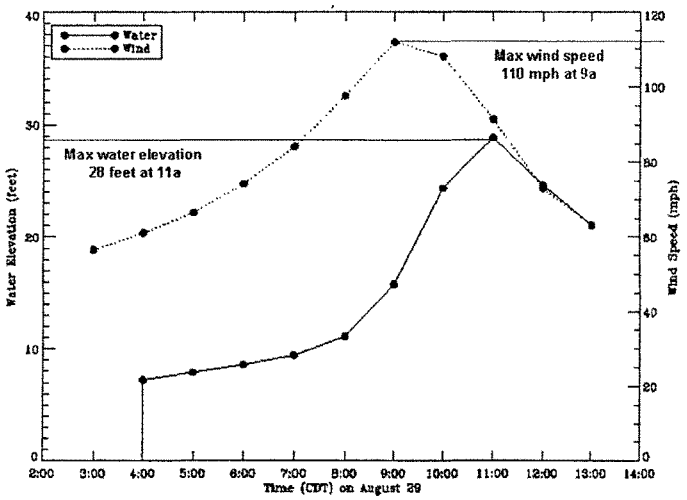
- **Category Four Hurricane**: Winds of 131-155 mph. Storm surge is generally 13-18 feet above normal. Some complete roof structure failures on small residences. Shrubs, trees, and all signs are blown down. Complete destruction of mobile homes. Extensive damage to doors and windows.

- **Category Five Hurricane**: Winds greater than 155 mph. Storm surge is generally greater than 18 feet above normal. Complete roof failure on many residences and industrial buildings. Some complete building failures with small utility buildings blown over or away. All shrubs, trees, and signs blown down. Complete destruction of mobile homes. Severe and extensive window and door damage.

Appendix F

Hancock County

Bay Saint Louis, MS
Coordinates: 30.32, 89.27

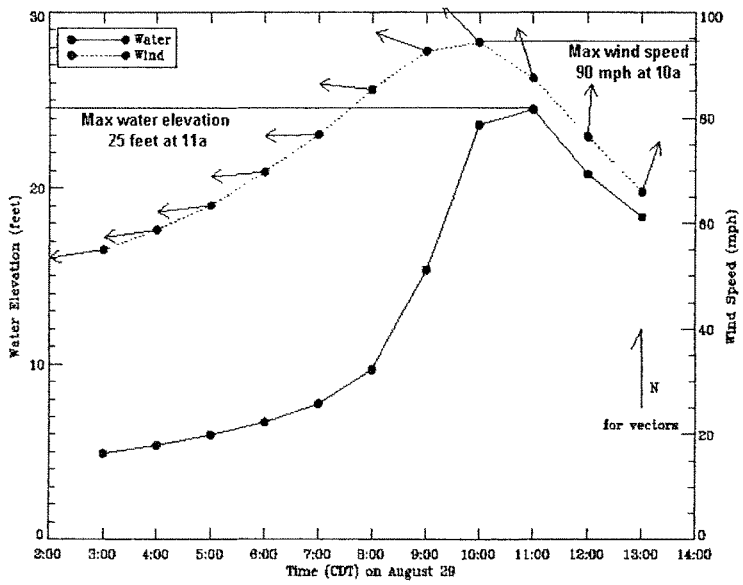


Note: **Wind over 100mph before water reaches 10 ft.**
Wind speeds remain above hurricane force for <u>4 hours</u> before water peaks.

Appendix F

Harrison County

Biloxi, MS
Coordinates 30.41, 88.9

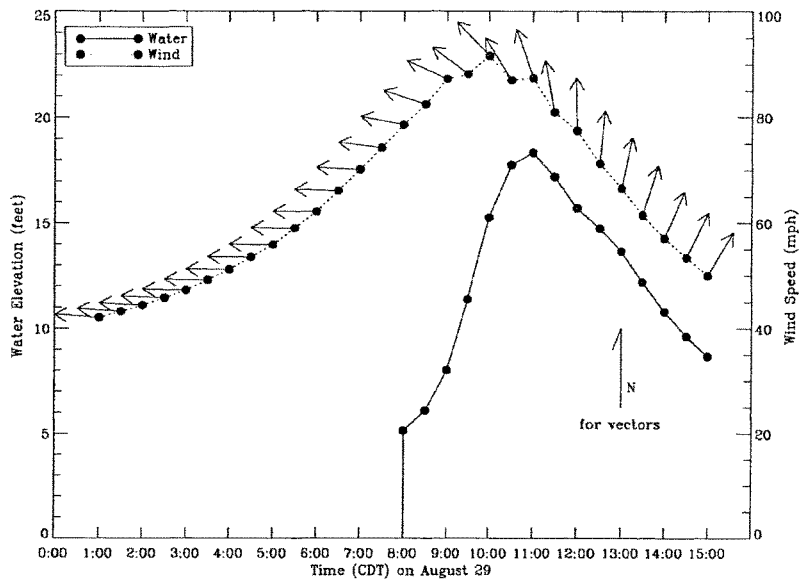


Note: Wind speeds sustained above hurricane force for <u>4 hours</u> before water peaks.

Appendix F

Jackson County

Ocean Springs, MS
Coordinates: 30.43, 88.84



Note: Wind speeds sustained above hurricane force for 4 hours before water peaks

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Oversight and Investigations, Committee on Financial Services, and the Subcommittee on Management, Investigations, and Oversight, Committee on Homeland Security, House of Representatives

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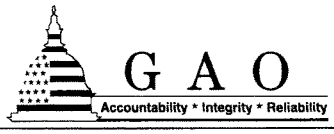
NATIONAL FLOOD INSURANCE PROGRAM

Preliminary Views on FEMA's Ability to Ensure Accurate Payments on Hurricane-Damaged Properties

Statement of Orice M. Williams, Director
Financial Markets and Community Investment



GAO-07-991T

June 2007

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Highlights

Highlights of GAO-07-991T, a testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, and the Subcommittee on Management, Investigations, and Oversight, Committee on Homeland Security, House of Representatives

NATIONAL FLOOD INSURANCE PROGRAM

Preliminary Views on FEMA's Ability to Ensure Accurate Payments on Hurricane-Damaged Properties

Why GAO Did This Study

Disputes between policyholders and property-casualty insurers over coverage from the 2005 hurricane season highlight challenges in determining the appropriateness of claims for multiple-peril events. In particular, events such as hurricanes that can cause both wind and flood damages raise questions about the adequacy of steps taken by the Federal Emergency Management Agency (FEMA) to ensure that claims paid by the National Flood Insurance Program (NFIP) covered only damages caused by flooding.

As a result, the Subcommittees asked GAO to provide preliminary views on (1) the information available to and obtained by NFIP through its claims process in determining flood damages for properties that sustained both wind and flood damages, and (2) the information collected by FEMA as part of the NFIP claims reinspection process.

GAO collected data from FEMA, reviewed reinspection reports, reviewed relevant policies and procedures, and interviewed agency officials and others knowledgeable about NFIP.

What GAO Recommends

This testimony is based on an ongoing engagement and, therefore, includes no recommendations. GAO anticipates making recommendations in its final report.

www.gao.gov/cgi-bin/getrpt?GAO-07-991TT.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Orice M. Williams at 202-512-8678, williamso@gao.gov.

What GAO Found

NFIP does not collect and analyze both wind and flood damage claims data in a systematic fashion, which may limit FEMA's ability to assess whether flood payments on hurricane-damaged properties are accurate. Instead, NFIP focuses only on the flood claims data to determine whether the amount actually paid on a claim reflects the damages caused by flooding. Flood claims data, collected by NFIP through the write-your-own (WYO) insurers—including those that sell and service both the wind and flood policies—do not include information on total damages to the property from all perils. That is, NFIP does not systematically collect information on wind damages from the WYO insurer when a flood claim is received. FEMA officials state that they do not have authority to collect wind damage claims data from WYO insurers, even when the insurer services both the wind and flood policies on the same property. As a result, for hurricane-damaged properties, such as those damaged by Hurricanes Katrina and Rita, NFIP does not have all the information it needs to ensure that its claims payments were limited to damage caused by flooding. Concerns over the processing of these flood claims are heightened when the same insurance company serves as both NFIP's WYO insurer and the property-casualty (wind) insurer for a given property. In such cases, the same company is responsible for determining damages and losses to itself and to NFIP, creating a potential conflict of interest.

The lack of both flood and wind damage data also limits the usefulness of FEMA's quality assurance reinspection program for NFIP flood claims. GAO found that the NFIP reinspection program did not incorporate a means for collecting and analyzing both the flood and wind damage data together in a systematic fashion to reevaluate the extent to which wind and flooding were deemed to have contributed toward damages to the property. Further, we explored whether the wind-related claims data collectively gathered by state insurance regulators would be useful to NFIP to reevaluate damage assessments. We determined that this information would be of limited value to NFIP in reevaluating wind versus flood damage determinations made because such data is not collected in enough geographic detail to match with the corresponding flood claims data on a property- or community-level basis. Without the ability to examine damages caused by both wind and flooding, the reinspection program is limited in its ability to confirm whether NFIP paid only for losses caused by flooding.

Mr. Chairmen and Members of the Subcommittees:

I am pleased to be here today to discuss our preliminary views on the National Flood Insurance Program (NFIP) and its access to the data needed to assess flood claims on properties damaged by both high winds and flooding in the aftermath of hurricanes. As we begin the 2007 hurricane season, disputes over coverage between policyholders and property-casualty insurers from the 2005 hurricane season continue to highlight the challenges of determining the appropriateness of claims for multiple-peril events. While these disputes center on the extent to which homeowners' insurance policies covered damages that resulted from wind, flooding, or some degree of both, they also bring to light the issues NFIP faces in servicing and validating flood claims from disasters such as hurricanes that may involve both flood and wind damages.

Key concerns raised from the 2005 hurricane season include whether or not some property-casualty insurance claims for wind-related damages were improperly shifted to NFIP at the expense of taxpayers. For properties subjected to both high winds and flooding, determinations must be made to assess the damages caused by wind, which may be covered through a property-casualty homeowners policy, and the damages caused by flooding, which may be covered by NFIP. The property-casualty insurer, NFIP, and the consumer all have a financial stake in the outcome of these determinations. Under NFIP, most flood damage claims are adjusted by private property-casualty insurers, known as the write-your-own (WYO) insurers, which sell and service flood insurance policies on the program's behalf.[1] Concerns over the processing of these flood claims are heightened when the same insurance company serves as both NFIP's WYO insurer and the property-casualty (wind) insurer for a given property. In such cases, the same company is responsible for determining damages and losses to itself and to NFIP, creating a potential conflict of interest.

Accordingly, questions have been raised about the information NFIP collects or has access to in these types of claims that would allow it to understand and validate the extent of damages caused by wind and flooding as a way to ensure that the allocation of damages and, as a result, the claims paid for flooding are accurate. As I indicated, knowing how

[1]NFIP contracts with private insurers to sell and administer flood insurance policies through the WYO arrangement, allowing the insurers to write flood policies backed by the federal government.

both wind and flooding contributed to damages is particularly important in addressing the potential conflict of interest that can arise when the same company is determining the wind and flood damages for itself and for NFIP, respectively. My remarks today focus on two aspects of the NFIP claims process. First, I will discuss the information available to and obtained by NFIP through its claims process in determining flood damages for properties subjected to both high winds and flooding. Second, I will discuss the information collected by the Federal Emergency Management Agency (FEMA) as part of the NFIP claims reinspection process.

My remarks today are based on our preliminary review of hurricane-related claims data systematically collected by NFIP for flood losses and by state insurance regulators for losses reported by property-casualty insurers for the 2005 hurricane season. Due to broad-based interest, the work supporting this statement is being done under the authority of the Comptroller General and is part of a larger effort being completed for the Ranking Member of the House Financial Services Committee. Our ongoing work addresses insurance issues related to wind versus flood damages and includes a review of how such determinations are made, who is making these determinations and how they are regulated, and the accuracy of claims payments based on the wind and flood damage determinations.

To complete our work, we have identified and reviewed the specific data elements and level of geographic detail available to NFIP on hurricane claims payments. In addition, we reviewed a statistically valid sample of files of reinspections that NFIP conducted on selected properties. We have also discussed information and issues associated with claims processing activities with NFIP, state insurance regulators, the National Association of Insurance Commissioners (NAIC), property-casualty insurers, state-sponsored wind insurers, insurance agents, claims adjusters, and industry associations. We conducted our work in accordance with generally accepted government auditing standards.

In summary:

Limited information is collected by NFIP to understand both the wind and flood damage determinations made for hurricane-damaged properties, limiting NFIP's ability to know whether claims paid under the flood policy were always limited to only flood damages. For a given hurricane-damaged property, because NFIP does not know how much of the damages were caused by wind and how much were caused by flooding, NFIP cannot determine whether the amount it paid accurately represents payment only for flood damage. This information is lacking even when the same

property-casualty insurance company serves as both the NFIP WYO insurer and the wind insurer. For properties experiencing both wind and flood damages, NFIP does not consistently collect information that would enable it to determine, either at the time the NFIP claim was paid or later, whether the amount paid on a flood damage claim reflects only the damages caused by flooding. Claims data collected by NFIP from WYO insurers, including those that sell and service both the wind and the flood policies, do not include information on total damages to the property from all perils—that is, they do not report the existence of wind damage nor the amount of damage caused by wind when servicing a flood claim on the same property. FEMA states that "claims paid by a WYO company that do not involve flood insurance proceeds (and the data related thereto) are not accessible by FEMA." Hence, NFIP does not systematically collect data on wind damages for properties for which a flood claim has been received. As a result, for hurricane-damaged properties subjected to both high winds and flooding, NFIP may not have all the information it needs to ensure that its claims payments were limited to only flood damages.

We found that the lack of both flood and wind damage data also limited the usefulness of FEMA's quality assurance reinspection program on NFIP flood claims when wind damage was also a factor. Specifically, the FEMA reinspection program did not incorporate a means for collecting and analyzing both the flood and wind damage data together in a systematic fashion to reevaluate the extent to which wind and flooding were deemed to have contributed toward damages to the property. We also explored whether the wind damage claims data that were collectively gathered by state insurance regulators after the 2005 hurricane season could provide information useful to NFIP to reevaluate damage assessments made and how they were apportioned between wind and flooding. We found that such data were not collected in sufficient geographic detail to match with corresponding flood claims data for a particular property, or even a neighborhood or city. Without the ability to examine damages caused by both wind and flooding, the reinspection program is limited in its usefulness as a tool to assess whether NFIP paid only for losses caused by flooding.

Background

Property owners in certain coastal regions subject to hurricanes and flooding may have to purchase at least two, and sometimes more, different types of insurance policies. Flood insurance is offered by NFIP, while insurance for wind-related damages is generally offered by private insurance companies or state-sponsored insurers. NFIP was established in 1968 in part to provide some insurance protection for flood victims

because the private insurers were and still are largely unwilling to insure for flood risks. The National Flood Insurance Act of 1968, as amended, allows homeowners to purchase up to $250,000 of NFIP coverage on their dwellings and up to an additional $100,000 for personal property such as furniture and electronics. Business owners may purchase up to $500,000 of coverage for dwellings and $500,000 on the contents. Exclusions under the flood policy include damages caused by wind or a windstorm. FEMA, which administers NFIP, is responsible for the management and oversight of NFIP and is assisted in performing these functions by a program contractor.

While NFIP provides the flood insurance policy and holds the risk, private property-casualty insurers, known as WYO insurers, sell and service approximately 95 percent of NFIP's flood policies. WYO insurers retain a portion of the premium for selling flood policies and receive fees for performing other administrative services for NFIP, but do not have any exposure to claims losses. A WYO insurer may or may not also provide coverage for wind-related risks on the same property.[2] After an event occurs, policyholders normally contact a WYO insurer to initiate a flood damage claim. If the claimant also has a policy for wind damage from the same WYO insurer, the company generally adjusts losses pertaining to both types of damages, those caused by wind and those caused by flooding. In such cases, the WYO insurer must determine and apportion the damages caused by wind that it insures, along with those caused by flooding, insured by NFIP.

To settle flood claims, insurance companies work with certified flood adjusters. When flood losses are reported, the WYO insurers assign flood adjusters to assess damages. The WYO insurers may use their own staff adjusters or contract with independent adjusters or adjusting firms to perform the flood adjustments. These adjusters are responsible for assessing damage, estimating losses, and submitting required reports, work sheets, and photographs to the insurance company, where the claim is reviewed and, if approved, processed for payment.

Both the insurance industry and NFIP incurred unprecedented storm losses from the 2005 hurricane season. State insurance regulators

[2]NFIP program contractors stated that they did not know how often the same WYO company also insured the property for wind damage because they did not systematically collect that information. However, a FEMA official we contacted stated that such a circumstance likely occurs in the majority of cases.

estimated that property-casualty insurers had paid out approximately $22.4 billion in claims tied to Hurricane Katrina (excluding flood), as of December 31, 2006.[3] However, industry observers estimate that insured losses tied to Hurricane Katrina alone (other than flood) could total more than $40 billion, depending on the outcome of outstanding claims and ongoing litigation. NFIP estimated that it had paid approximately $15.7 billion in flood insurance claims as of January 31, 2007, encompassing approximately 99 percent of all flood claims received.

NFIP Does Not Systematically Collect and Analyze Data on Related Wind Damages When Collecting Flood Claims Data

For hurricane-damaged properties, NFIP does not know whether both wind and flooding contributed toward damages nor the apportionment of damages between them, limiting its ability to monitor the accuracy of flood payments and address potential conflicts of interest that may arise in certain damage scenarios. Based on our preliminary review, we found that NFIP did not systematically collect and analyze data on wind-related damage when collecting flood claims data on properties subjected to both high winds and flooding, such as those damaged in the aftermath of Hurricanes Katrina and Rita. Further, such information is not sought even when the same insurance company serves as both the NFIP WYO insurer and the insurer for wind-related risks, posing a potential conflict in certain damage scenarios where properties are subjected to both types of perils. Without information on both wind and flood damages to the property, NFIP may not know on certain hurricane-damaged properties whether the amount it paid for a claim was limited to flood damage.

As mentioned earlier, NFIP's WYO insurer may also insure the same property for wind-related damages. In this situation, a potential conflict of interest can materialize because the WYO insurer has a financial interest in the outcome of the claims adjustment it performs on behalf of NFIP. Conversely, if the policy for wind-related risks were issued by another insurer, the same potential conflict of interest would not exist because the flood and wind damages would be assessed and determined separately by different insurers.

WYO insurers are required to submit flood damage claims data in accordance with NFIP's Transaction Record Reporting and Processing

[3]Claims paid as reported to NAIC by property-casualty insurers as of December 31, 2007, for multiple lines of business, including fire and allied lines, farm owners, homeowners, mobile homeowners, commercial multi-peril, commercial auto physical damage, private passenger auto physical damage, ocean marine, and other lines (excluding flood).

(TRRP) Plan, for inclusion into NFIP's claims database.[4] In our review of data elements in NFIP's claims database, we found that NFIP does not require WYO insurers, which are responsible for adjusting the flood claim, to report information on property damages in a manner that could allow NFIP to differentiate how these damages (to the building or its contents) were divided between wind and flooding, even when the WYO insurer is also the wind insurer for the property.

Specifically, the TRRP Plan for WYO insurers instructs them to include only flood-related damages in the data fields on "Total Building Damages" and "Total Damage to Contents." Further, the "Cause of Loss" data field does not incorporate an option to explicitly identify property damages caused by wind or partially caused by wind (e.g. combined wind and flood, hurricane, windstorm, etc.). As a result, WYO insurers do not report total property damages in a manner that 1) identifies the existence of wind damage or 2) discerns how damages were divided between wind versus flooding for properties that were subjected to a combination of both perils. Further, NFIP program contractors stated that they do not systematically track whether the WYO insurer processing a flood claim on a property is also the wind insurer for that property. This lack of transparency over both the wind and flood damages on hurricane-damaged properties limits NFIP's ability to verify that damages paid for under the flood policy were caused only by the covered loss of flooding.

NFIP's normal claims processing activities, which do not incorporate a means to systematically collect information on wind-related damages, were further stressed during the 2005 hurricane season. For both Hurricanes Katrina and Rita, FEMA estimates that it has paid approximately $16.2 billion in claims, with average payments of over $95,000 and $47,000, respectively. As we reported in December of 2006, in an effort to assist policyholders, NFIP approved expedited claims processing methods that were unique to Hurricanes Katrina and Rita.[5] Some expedited methods included the use of aerial and satellite photography and flood depth data in place of a site visit by a claims

[4]NFIP requires each WYO company to meet the requirements of the WYO Transaction Record Reporting and Processing Plan and to submit monthly financial and statistical reports as required in FEMA regulation 44C.F.R., part 62, Appendices A and B.

[5]GAO, *National Flood Insurance Program: New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved*, GAO-07-169 (Washington, D.C.: Dec. 15, 2006).

adjuster for properties where it was likely that covered damages exceeded policy limits. Under other expedited methods, FEMA also authorized claims adjustments without site visits where only foundations were left and square foot measurements of the dwellings were known.[6] Such expedited procedures facilitated the prompt processing of flood claims payments to policyholders following the unprecedented damage of the 2005 hurricanes. However, once these flood claims were processed, as was the case for other flood claims on hurricane-damaged properties, NFIP did not systematically collect wind damage claims data tied to flood-damaged properties on an after-the-fact basis. Hence, NFIP does not know the extent to which wind contributed to total property damages.

FEMA officials stated that they do not have access to wind damage claims data from the WYO insurers. Specifically, a letter from FEMA to GAO stated that:

> "FEMA's opinion is that, where flood insurance payments have been made, FEMA is permitted to review the background claims data in order to ensure that insurance claims payments are appropriately allocated to flood losses as opposed to wind-related losses. Such data may include the adjuster's report(s) and any engineering reports that support (or fail to support) the allocation of loss to flood versus wind damage. FEMA may request summaries and analyses of this information at any time to ensure proper processing of flood claims. Conversely, claims paid by a WYO company that do not involve flood insurance proceeds (and the data related thereto) are not accessible by FEMA, and indeed, do not need to be, as there would have been no improper allocation of flood insurance proceeds for wind losses. Moreover, the attempt to access this unrelated data may be found to violate various privacy protections."

Hence, NFIP does not systematically collect data on wind damages for properties for which a flood claim has been received. As a result, for hurricane damaged properties subjected to both high winds and flooding, NFIP may not have all the information it needs to ensure that its claims payment was limited to only flood damage.

[6]Approximately 11 percent of all Hurricane Katrina claims were adjusted using expedited procedures, according to the FEMA director of NFIP claims.

FEMA's Reinspection Program Has Limited Ability to Validate the Accuracy of Payments on Hurricane-Damaged Properties

FEMA's reinspection program, which helps validate the adjustment process and flood payments made, provides limited information that could enable FEMA to better validate the claims payments it makes for flood damage when wind is also a factor. Based on our preliminary review, the reinspection program does not systematically evaluate the apportionment of damages between wind and flooding, even when a potential conflict of interest may arise with the WYO insurer. Along with flood claims data collected from WYO insurers that service flood policies, FEMA, through its program contractor, operates a reinspection program to monitor and oversee claims adjustments and address concerns about flood payments. The stated purpose of the reinspection program is to reevaluate the flood adjustment and claim payment made on a given property to determine whether or not NFIP paid the correct amount for flood-related damages. This is accomplished through on-site reinspections and reevaluations of a sample of flood claim adjustments. However, we found that FEMA's reinspection program did not systematically incorporate a means for identifying whether nor the extent to which wind-related damages contributed to the losses. Without the ability to examine damages caused by both wind and flooding, the reinspection program is limited in its ability to assess whether NFIP paid only the portion of damages it was obligated to pay under the flood policy.

During our study, we reviewed hundreds of reinspection files for properties with flood claims tied to Hurricanes Katrina and Rita. We found that the reinspection files did not confirm that the claim paid actually reflected only the damage covered by the flood insurance policy versus damage caused by other, uncovered damages, such as wind. Rather, the reinspection files generally contained limited and inconsistent documentation concerning the presence or extent of wind-related damages on properties without additional documentation that would enable FEMA to evaluate both the wind and flood damage information together.

Specifically, the reinspection files reviewed did not consistently document whether or not damages were caused by a combination of both wind and flooding. The reinspection activities focused on reevaluating the extent to which building and content damages were caused by flooding. While some of the reinspection files included documentation as to whether or not damage was caused by a combination of wind and flooding, most did not. Information reviewed from 740 reinspection files revealed that nearly two-thirds of these reinspection reports did not include documentation to indicate whether damages were caused by a combination of both wind and flooding or only flooding. We found that approximately 26 percent

included documentation indicating damage was caused only by flooding, while approximately 8 percent of the reinspection files included documentation that damages were caused by a combination of wind and flooding. In cases where reinspectors indicated that damages were caused by a combination of wind and flooding, insufficient data existed to assess the extent that wind contributed to the damages. That is, information about the wind damage during the reinspection process was not documented or analyzed in a systematic fashion. Hence, the reinspection activities did not systematically document or validate the presence or extent of wind damage in combination with flood damage in order to verify that flood payments were limited to flood damage. Moreover, as we have previously reported, FEMA does not choose a statistically valid sample for its reinspection process. Therefore, the results could not be projected to the universe of properties for which flood claims were made.[7]

We also noted that on-site reinspections of properties with flood claims tied to Hurricanes Katrina and Rita were generally conducted several months after the event. Such delays, while understandable considering the scope and magnitude of devastation resulting from these hurricanes in 2005, further limited NFIP's ability to reevaluate the quality and accuracy of the initial damage determination, given the ongoing natural and manmade events that continued to alter the damage scene.

Finally, we explored whether NFIP could use data collectively gathered by state insurance regulators on property-casualty claims resulting from the 2005 hurricane season to match with NFIP flood claims data. We found that while Florida, Mississippi, Louisiana, Alabama, and Texas collected some aggregate information about claims from the property-casualty insurers, such data would have been of limited value to NFIP to evaluate the accuracy of its flood claims payments in any systematic way. Except for Florida, which had previously collected aggregate claim data from property-casualty insurers for major hurricane events, the other states used a special data call, based on Florida's system, to collect this aggregate claims data from the property-casualty insurers. However, the information collected was not in sufficient geographic detail to allow a meaningful evaluation of wind versus flood damage assessments and

[7]GAO, *Federal Emergency Management Agency: Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program*, GAO-06-119 (Washington, D.C.: Oct.18, 2005).

apportionments made by insurers.[8] That is, claims data reported by property-casualty insurers through this mechanism were either reported on a statewide or county/parish-level basis that did not allow it to be matched with corresponding flood claims data on a community-level (e.g. zip code) or a property-level basis.

In summary, based on our preliminary review, NFIP does not collect the information it needs to help evaluate whether it has paid only what it is obligated to pay under the flood policy for properties subjected to both high winds and flooding, such as those damaged by hurricanes Katrina and Rita. For these properties, NFIP did not systematically collect enough information to know whether there was wind damage, much less enough to understand how much of the damage was determined to have been caused by wind and how much was caused by flooding. Without the ability to collect information that documents both the flood and wind damage, NFIP's capacity to evaluate the accuracy of its payments is limited. As mentioned earlier, this is particularly important in situations where the WYO insurer also insures the property for wind damages. This creates a potential conflict of interest when the same insurer makes both the wind and flood damage assessments, because the insurer is effectively apportioning losses between itself and NFIP. Obtaining both the flood and wind adjustment claims data, whether from the same WYO insurer that services both or from different insurers, would be necessary to NFIP to verify the accuracy of the payments made for flood claims.

Information collected and assessed through FEMA's claims reinspection program is also of limited usefulness in confirming or validating the accuracy of flood payments made by NFIP on properties damaged by both wind and flooding. Without the additional information about wind damage on properties for which flood claims were also filed, NFIP may not be

[8]In the aftermath of Hurricanes Katrina and Rita, state insurance regulators in Mississippi, Louisiana, Alabama, Texas, and Florida jointly established a data call mechanism to collect aggregate claims data tied to the storms reported by property-casualty insurers. These states collectively referred to the entire data call mechanism as the Insurance Disaster Reporting System (IDRS). It enabled regulators to better understand the total number of claims tied to the storms, the type of claims, the extent of losses, and the number of claims considered closed by property-casualty insurers. In general, the aggregate claims data were collected either at a state or county (parish) level depending on the phase of reporting. The IDRS data capture mechanism was originally developed by the state of Florida and was undergoing a redevelopment when Hurricanes Katrina and Rita hit. State insurance regulators, with the assistance of NAIC staff, decided to use this data capture mechanism because it was readily available, even recognizing its limitations. IDRS was not designed to monitor damages on a property-by-property basis.

certain whether it has paid only for the flood damages to these properties. Finally, we determined that using hurricane claims data collected by state insurance regulators would not have provided data on a property- or community-level basis to help NFIP determine how much damage was caused by wind versus flooding, and how these damages were apportioned between the two perils. The lack of both wind and flood claims data limits NFIP's ability to assess whether payments made on flood claims from the 2005 hurricane season were accurate.

Mr. Chairmen, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Subcommittees may have.

Contacts and Acknowledgments

For additional information about this testimony please contact Orice M. Williams on (202) 512-8678 or at williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Lawrence D. Cluff, Assistant Director; Tania Calhoun; Emily Chalmers; Rudy Chatlos; Chir-Jen Huang; Barry Kirby; and Melvin Thomas.

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EDITORIAL: Where's the outrage?

TIMES PICAYUNE
Sunday, June 10, 2007

Despite eye-popping allegations that eight major insurance companies improperly shifted what could total billions of dollars in Katrina claims to the federal government's flood insurance program, no one in government seemed to be riled up about the matter.

That should change now.

U.S. District Judge Peter Beer apparently isn't happy with the government's non-response to a whistleblower lawsuit filed by a group of former insurance adjusters who claim that the government was systematically defrauded after Katrina.

Judge Beer, who unsealed the lawsuit in May, filed a one-sentence motion last week calling for federal prosecutors to get involved in the case or explain why they refuse to do so. The motion puts pressure on Attorney General Alberto Gonzales and U.S. Attorney David Dugas in Baton Rouge to do something.

Judge Beer, who serves in the court's Eastern District in New Orleans, expressed surprise that Mr. Dugas' office had planned only to monitor the case. The lawsuit currently is being pursued by a private attorney representing the whistleblowers. "What about the good old general public? Who better to look after the interests of the public than the U.S. attorneys?" Judge Beer said.

Those are very good questions. The accusations in the lawsuit are so serious that it is almost unfathomable that the U.S. government would ignore them.

Judge Beer, who is privy to more details than the public has seen so far, says "the United States should be right in there, and not just monitoring it, given as far-reaching and serious as this case is."

He is right. Even without every detail of every example laid out by the whistleblowers, that is clear.

The former insurance adjusters who filed the lawsuit say they have reinspected 150 properties with flood and wind damage. In every case, they found that the flood claim had been inflated and the wind claim underestimated. Not in some cases, in every case.

The average overpayment from the flood program was 66 percent. If that calculation were to hold true over the entire body of claims, the improper costs to the flood program could total more than $9 billion. For every dollar shifted to the government program, the insurers saved on their own costs for wind coverage.

Even $1 million in fraudulent claims would be offensive. The public subsidizes the flood program, so all of us are on the hook if it is cheated out of money.

Some of the examples gathered by the adjusters are truly brazen:

For instance, the suit claims that State Farm paid a Metairie homeowner $88,280 for flood damages although there was no flooding in the home. The company apparently paid out only $5,379 on its homeowners policy. The adjusters who filed the lawsuit, known collectively as Branch Consultants, say that the home actually had $110,918 in wind damage, which would properly be paid under the homeowners' policy.

State Farm also calculated $45,000 in roof damage, exterior finish work and framing as part of a flood claim on a West Bank home that had only eight inches of water inside, the lawsuit says. The homeowner was paid only $5,768 for wind damage, but the Branch Consultants say the home had $95,030 in wind losses.

An Allstate claim counted flood damage twice on an eastern New Orleans home, the adjusters say. American National Property & Casualty Insurance Co. gave one property owner in Versailles Gardens $95,000 in flood damages, even though no floodwaters got into the buildings, they say.

And the list goes on. Insurers would pump up the charges to the government and underestimate their own liability.

It is surprisingly easy to do so. Insurers issue flood policies to homeowners, who pay a premium subsidized by the government. When a claim is made, insurance companies have the authority to write checks on the government's accounts. They are supposed to make sure that payouts on the flood policy actually are for flood losses, but that doesn't seem to have happened in these cases.

Perhaps that is not entirely surprising given the immense damage from Hurricanes Katrina and Rita and the massive flooding caused by the collapse of the federal government's levees. When flood program officials decided early-on to expedite payments to victims, cost shifting might have

looked like an easy out for insurers.

But taxpayers have to foot the bill for any shortfall in the program. In the months after Katrina, Congress approved a total of $18.5 billion in borrowing power for the flood program, which had been quickly overwhelmed by claims.

If it turns out that private insurers bilked the flood program for any part of those claims, the government ought to do something about it. At the least, those firms should repay the U.S. Treasury. And if insurers defrauded the government, someone should go to jail.

JAN. 30. 2006 8:15AM FSC NO. 4915 P. 2

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U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
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January 24, 2006

The Honorable David M. Walker
Comptroller General
United States Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

06-0324

Dear Mr. Walker:

The House Financial Services Committee has been examining the problems caused by the unprecedented number of hurricanes that have made landfall on the United States over the past three years. The number and severity of these storms has severely strained the nation's insurance marketplace. In fact, insurance claims from the 2005 hurricanes in Louisiana alone may enough to wipe out all homeowners premiums paid in the state during the last 25 years. These enormous losses may result in greatly increased costs and fewer choices for consumers nationwide. With meteorologists predicting that hurricanes will continue to be more frequent and more intense over the next 20 years, it is imperative that Congress continue to examine potential approaches to improving disaster insurance protection for consumers.

Accordingly, the Committee requests that the Government Accountability Office (GAO), in consultation with the NAIC and representatives of the insurance industry, including a cross section of insurers, independent insurance agents, brokers, and policyholders, examine and conduct a study concerning the need for government legislation facilitating better protection for insured losses resulting from natural disasters including hurricanes, extreme windstorms, earthquakes, and catastrophic fires. The study shall include an analysis of whether, and in what manner, such government legislation should incorporate any or all of the following concepts: tax-free capital reserves; voluntary mutual reinsurance pools; a distinction between sophisticated and non-sophisticated commercial purchasers for the purposes of exemption from regulation; and shared public-private disaster reinsurance. The report should also examine how insurance claims adjusters make a determination that storm damages is caused by wind or flooding, assess what mitigation efforts can be done to reduce natural disaster insurance losses, and identify potential solutions to decrease the number of consumers that are uninsured or underinsured for catastrophic risk exposures. This report shall be submitted to the House Financial Services Committee no later than September 30, 2006.

FMCI

The Honorable David M. Walker
Page 2

Please contact Glenn Westrick, Counsel of the House Financial Services Committee, if you have any questions related to this request.

Yours truly,

Michael G. Oxley
Chairman

MGO/gew

cc: Barney Frank, Ranking Member

TITLE I

DEPARTMENTAL MANAGEMENT AND OPERATIONS

Office of the Secretary and Executive Management

For necessary expenses of the Office of the Secretary of Homeland Security, as authorized by section 102 of the Homeland Security Act of 2002 (6 U.S.C. 112), and executive management of the Department of Homeland Security, as authorized by law, $94,470,000: *Provided,* That not to exceed $40,000 shall be for official reception and representation expenses: *Provided further,* That of the funds provided under this heading, $5,000,000 shall not be available for obligation until the Secretary of Homeland Security submits a comprehensive port, container, and cargo security strategic plan to the Committees on Appropriations of the Senate and the House of Representatives; the Committee on Homeland Security of the House of Representatives; the Committee on Homeland Security and Governmental Affairs of the Senate; and the Committee on Commerce, Science, and Transportation of the Senate that requires screening all inbound cargo, doubles the percentage of inbound cargo currently inspected, sets minimum standards for securing inbound cargo, and includes the fiscal year 2007 performance requirements for port, container, and cargo security as specified in the joint explanatory statement accompanying this Act: *Provided further,* That of the funds provided under this heading, $10,000,000 shall not be available for obligation until the Secretary submits the Secure Border Initiative multi-year strategic plan to the Committees on Appropriations of the Senate and the House of Representatives, the Committee on Homeland Security of the House of Representatives, the Committee on Homeland Security and Governmental Affairs of the Senate, and the Committees on the Judiciary of the Senate and the House of Representatives no later than December 1, 2006, that includes: a comprehensive mission statement, an identification of long-term goals, an explanation of how long-term goals will be achieved, schedule and resource requirements for goal achievement, an identification of annual performance goals and how they link to long-term goals, an identification of annual performance measures used to gauge effectiveness towards goal achievement by goal, and an identification of major capital assets critical to program success.

Office of the Under Secretary for Management

For necessary expenses of the Office of the Under Secretary for Management, as authorized by sections 701 through 705 of the Homeland Security Act of 2002 (6 U.S.C. 341 through 345), $153,640,000: *Provided,* That not to exceed $3,000 shall be for official reception and representation expenses: *Provided further,* That of the total amount provided, $8,206,000 shall remain available until expended solely for the alteration and improvement of facilities, tenant improvements, and relocation costs to consolidate Department headquarters operations.

Office of the Chief Financial Officer

For necessary expenses of the Office of the Chief Financial Officer, as authorized by section 103 of the Homeland Security Act of 2002 (6 U.S.C. 113), $26,000,000.

Office of the Chief Information Officer

For necessary expenses of the Office of the Chief Information Officer, as authorized by section 103 of the Homeland Security Act of 2002 (6 U.S.C. 113), and Department-wide technology investments, $349,013,000; of which $79,521,000 shall be available for salaries and expenses; and

of which $269,492,000 shall be available for development and acquisition of information technology equipment, software, services, and related activities for the Department of Homeland Security, and for the costs of conversion to narrowband communications, including the cost for operation of the land mobile radio legacy systems, to remain available until expended: *Provided,* That none of the funds appropriated shall be used to support or supplement the appropriations provided for the United States Visitor and Immigrant Status Indicator Technology project or the Automated Commercial Environment: *Provided further,* That the Chief Information Officer shall submit to the Committees on Appropriations of the Senate and the House of Representatives, not more than 60 days after the date of enactment of this Act, an expenditure plan for all information technology projects that: (1) are funded under this heading; or (2) are funded by multiple components of the Department of Homeland Security through reimbursable agreements: *Provided further,* That such expenditure plan shall include each specific project funded, key milestones, all funding sources for each project, details of annual and lifecycle costs, and projected cost savings or cost avoidance to be achieved by the project.

Analysis and Operations

For necessary expenses for information analysis and operations coordination activities, as authorized by title II of the Homeland Security Act of 2002 (6 U.S.C. 121 et seq.), $299,663,000, to remain available until September 30, 2008, of which not to exceed $5,000 shall be for official reception and representation expenses.

Office of the Federal Coordinator for Gulf Coast Rebuilding

For necessary expenses of the Office of the Federal Coordinator for Gulf Coast Rebuilding, $3,000,000: *Provided,* That $1,000,000 shall not be available for obligation until the Committees on Appropriations of the Senate and the House of Representatives receive an expenditure plan for fiscal year 2007.

Office of Inspector General

For necessary expenses of the Office of Inspector General in carrying out the provisions of the Inspector General Act of 1978 (5 U.S.C. App.), $85,185,000, of which not to exceed $100,000 may be used for certain confidential operational expenses, including the payment of informants, to be expended at the direction of the Inspector General: *Provided,* That the Department of Homeland Security Inspector General shall investigate whether, and to what extent, in adjusting and settling claims resulting from Hurricane Katrina, insurers making flood insurance coverage available under the Write-Your-Own program pursuant to section 1345 of the National Flood Insurance Act of 1968 (42 U.S.C. 4081) and subpart C of part 62 of title 44, Code of Federal Regulations, improperly attributed damages from such hurricane to flooding covered under the insurance coverage provided under the national flood insurance program rather than to windstorms covered under coverage provided by such insurers or by windstorm insurance pools in which such insurers participated: *Provided further,* That the Department of Homeland Security Inspector General shall submit a report to Congress not later than April 1, 2007, setting forth the conclusions of such investigation.

SEALED

FILED
U.S. DISTRICT COURT
EASTERN DISTRICT OF LA
2006 AUG -2 PM 4:00
LORETTA G. WHYTE
CLERK

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF LOUISIANA

UNITED STATES OF AMERICA, *EX REL.* BRANCH CONSULTANTS, L.L.C.,	)	
Plaintiff,	)	
v.	)	Case No. 06-4091
ALLSTATE INSURANCE COMPANY, STATE FARM FIRE AND CASUALTY COMPANY, LIBERTY MUTUAL FIRE INSURANCE COMPANY, FIDELITY NATIONAL INSURANCE COMPANY, FIDELITY NATIONAL PROPERTY AND CASUALTY INSURANCE COMPANY, AMERICAN NATIONAL PROPERTY & CASUALTY COMPANY, SCOTTSDALE INSURANCE COMPANY, ST. PAUL TRAVELERS COS., PILOT CATASTROPHE SERVICES, INC., CRAWFORD & COMPANY, ALLIED CLAIMS, INC., NCA GROUP, INC., INC., SIMSOL INSURANCE SERVICES, INC., AND JOHN DOES 1-100,	)	**FILED IN CAMERA AND UNDER SEAL** SECT. M MAG 1
Defendants.	)	**JURY TRIAL DEMANDED**

COMPLAINT

1. Individually and on behalf of the United States of America, Plaintiff and *qui tam* relator Branch Consultants, L.L.C. alleges as follows:

I. NATURE OF THE ACTION

2. Branch Consultants brings this action to recover damages, penalties and attorneys' fees for violations of the False Claims Act, 31 U.S.C. §§ 3729-33 ("FCA"), committed by the defendants.

Fee 350.00
Process
X Dktd
CtRmDep
Doc. No

704605v1/009717

3. The defendants have defrauded the Government through a practice of grossly overstating flood damages to insured properties resulting from Hurricane Katrina and then, based on those overstated damages, submitting claims for payment on Government-backed flood insurance policies to the National Flood Insurance Program ("NFIP"). By systematically obtaining and submitting false flood insurance claims to NFIP, and by actively concealing these practices from the Government, the defendants have submitted or caused to be submitted to the Government a series of false claims, records and statements in violation of the FCA.

4. By these practices, the defendants have put into effect a fraudulent scheme to defraud the Government and thereby reap the profits of the fraud. Although the proceeds of the flood claim payments purportedly go to reimburse defendants for their administrative services and for flood claim payments they have already advanced to the insureds, the gross overstating of flood damages benefits the defendants because the damages that are misattributed to flooding should instead have been attributed to wind or similar causes that are covered by homeowners insurance policies—policies that the insurer defendants have typically issued themselves.

5. This scheme is pervasive and has caused the Government to pay hundreds of millions if not billions of dollars in fraudulent flood insurance claims.

II. FALSE CLAIMS ACT

6. The FCA provides that any person who knowingly submits or causes to be submitted a false or fraudulent claim to the Government for payment or approval is liable for three times the amount of the damages sustained by the Government. In addition, the FCA imposes a civil penalty of not less than $5,500 and not more than $11,000 for each such claim submitted or paid. Liability attaches when a defendant knowingly seeks payment that is unwarranted from the Government and/or when false records or statements are knowingly created or caused to be used to conceal, avoid or decrease an obligation to pay or transmit money to the Government.

7. The FCA allows any person having information regarding a false or fraudulent claim against the Government to bring a *qui tam* action (as "relator") on behalf of the Government and to share in any recovery. In such cases, the Complaint is served on the Attorney General of the United States and local United States Attorney, and it is filed under seal for 60 days (without service on the defendants during that period). This procedure enables the Government to (a) conduct its own investigation without the defendant's knowledge and (b) determine whether to join the action as intervenor.

8. Based on these provisions, plaintiff/relator Branch Consultants seeks to recover treble damages, civil penalties and attorneys' fees arising from false and fraudulent claims, records and statements made to the Government in order to obtain payments under NFIP.

III. PARTIES

9. Plaintiff/relator Branch Consultants is a Georgia corporation located at 4720 Southshore Drive, Metairie, Louisiana 70002. Branch Consultants brings this action for violations of 31 U.S.C. §§ 3729-33 on behalf of itself and the United States Government pursuant to 31 U.S.C. § 3730(b)(1). Branch Consultants has direct, first-hand knowledge of the falsity of the records, statements and/or claims defendants have presented to the Government and of their fraudulent scheme. Branch Consultants is an original source of the information on which this Complaint is based, including any such information that has been publicly disclosed, because Branch Consultants, its principals and its employees have directly and independently discovered this information.

10. Defendant Allstate Insurance Company is a nationwide insurer headquartered at Allstate Plaza, E5, NorthBrook, Illinois 60062. Defendant State Farm Fire And Casualty Company is a nationwide insurer headquartered at One State Farm Plaza, Bloomington, IL 61710. Defendant Liberty Mutual Fire Insurance Company is a nationwide insurer headquartered at 175 Berkeley Street, Boston, Massachusetts 02116. Defendants Fidelity National Insurance Company and Fidelity National Property And Casualty Insurance Company are nationwide insurers headquartered at 601 Riverside Avenue, Jacksonville, FL 32204. Defendant American National Property & Casualty Company is a nationwide insurer headquartered at American National Corporate Centre, 1949 E. Sunshine, Springfield, MO 65899. Defendant Scottsdale Insurance Company is a nationwide insurer headquartered at 8877 N. Gainey Center Drive, Scottsdale, AZ 85258. Defendant St. Paul Travelers Cos. is a nationwide insurer headquartered at 385 Washington Street, Saint Paul, MN 55102. Collectively, these are the insurer defendants.

11. Defendant Pilot Catastrophe Services, Inc., is a catastrophe insurance adjusting firm headquartered at 1055 Hillcrest Road, Suite F-1, Mobile, AL 36695. Defendant Crawford & Company is a catastrophe insurance adjusting firm headquartered at P.O. Box 5047, Atlanta, GA 30302. Defendant NCA Group, Inc., is a catastrophe insurance adjusting firm headquartered at 9785 Crosspoint Blvd, # 100, Indianapolis, IN 46246. Defendant Simsol Insurance Services, Inc., is a catastrophe insurance adjusting firm headquartered at 1845 E John Sims Parkway, Niceville, FL 32578. Defendant Allied Claims, Inc., is a catastrophe insurance adjusting firm headquartered at 1400 N.E. 53rd Court, Fort Lauderdale, Florida 33334. Together, these are the adjuster defendants.

IV. JURISDICTION AND VENUE

12. The United States District Court for the Eastern District of Louisiana has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. § 1331. Moreover, 31 U.S.C. § 3732(a) specifically confers jurisdiction over FCA actions on federal district courts. The defendants are subject to personal jurisdiction in this district because each of them has minimum contacts with the forum and can be served here via their registered agents.

13. Venue is proper in this district pursuant to 31 U.S.C. § 3732(a) because the defendants can each be found in and/or each transacts business within the district. Venue is also proper because many of the FCA violations which are the subject of this action occurred within this district.

V. NATURE OF THE CASE

14. NFIP makes federally-backed flood insurance available to homeowners, renters, and business owners in flood-prone communities and elsewhere. Initially, NFIP flood insurance was available only via insurance agents who dealt directly with the Federal Insurance Administration. But in 1983 the Federal Emergency Management Agency (FEMA) created the Write-Your-Own ("WYO") Program, which allows a pool of participating property/casualty insurance companies—including the insurer defendants—to write and service NFIP's Standard Flood Insurance Policy in their own names.

15. When a private insurer becomes a WYO insurer, it agrees to what is known as the Financial Assistance/Subsidy Arrangement ("Arrangement") with the Federal Insurance Administration ("FIA"), which administers NFIP.[1] FIA requires the WYO insurers to adjust flood claims and to settle, pay and defend all claims arising from the flood policies they write. Then, pursuant to the Arrangement, the WYO insurers submit what are effectively reimbursement requests for the flood claims they have paid. They also receive a fee from FIA for writing and administering the policies, as well as a fee for adjusting the claims. Nearly all of the flood insurance policies issued in the United States today are written through WYO policies and administered in this way. The defendants are WYO insurers and their adjusters. There are approximately 95 WYO insurers operating in the Gulf Coast area.

[1] In 2004, President Bush signed into law the Flood Insurance Reform Act, reauthorizing the NFIP through 2008. The NFIP is currently managed by the Mitigation Division within FEMA. FEMA is part of the Department of Homeland Security's Emergency Preparedness and

16. Generally, the NFIP policies cover losses to structures and contents due to flooding. They generally do not cover losses that typical homeowners insurance policies cover, such as losses caused by wind or lightening or fire.

17. In the aftermath of Hurricane Katrina and unprecedented volumes of claims following the 2005 hurricane season, FEMA waived the requirement that insureds file a Proof of Loss in connection with Katrina-related claims under NFIP's Standard Flood Insurance Policy. Shortly thereafter, FEMA announced an expedited claim handling process for Katrina-related flood claims. Defendants were thus put in the position of having essentially total control over the Standard Flood Insurance Policy claims they were handling, and their adjustments alone have served as the basis for thousands of claims submitted to NFIP. Rather than follow in good faith the streamlined procedures that FEMA set up, defendants instead systematically adjusted, paid and submitted reimbursement claims to NFIP regarding losses that obviously should not be covered by the flood policies. They did so in massive quantities. In other words, defendants defrauded NFIP by misattributing wind damage and other non-flood losses to the flood policies underwritten by the Government rather than correctly attributing such losses to causes that are covered by their homeowners policies.

Response Directorate. Since August, 2001, FIA has been renamed as the Federal Insurance and Mitigation Administration.

18. As a result of this fraud, NFIP's average flood claim payment increased from approximately $32,000 or less per claim in 2004 and all preceding years to approximately $100,000 per claim on Hurricane Katrina flood claims. Having never before exceeded $1.3 billion in flood claims in single year, current estimates put 2005 NFIP claims at $10 to 30 billion.

19. Branch Consultants is an insurance and construction consulting firm that has been retained by numerous insureds to re-examine adjustments done by the WYO insurers' in-house adjusters or other adjuster agencies employed by them following Hurricane Katrina. The principals and consultants of Branch Consultants include experienced adjuster and construction personnel with many decades of construction and construction-estimating experience. In performing re-examinations, they have found, *inter alia*, the following:

a. numerous examples of minimal if any flood damage and obvious wind damage, with a WYO adjustment of 100% flood damage,

b. buildings with substantial roof and other damage obviously caused by wind, and *a high-water mark only inches off the floor*, with all damage nonetheless attributed only to flood, and

c. buildings with a substantial amount of flood damage but even more wind damage adjusted at or near flood policy limits with a relatively small portion of the loss attributed to wind.

20. In fact, on nearly all of the hundreds of properties inspected by Branch Consultants in various areas in and about southern Louisiana, defendants have maxed out or nearly maxed out the insured's flood claim (underwritten by NFIP), irrespective of the actual damage conceivably attributable to flood. At the same time, defendants substantially underpaid for the damage that should have been attributed to wind (underwritten by defendants) on these same claims.

21. The following non-exclusive examples illustrate the defendants' scheme:

a. Jane Doe 1, 2124 Music St., New Orleans, LA 70117 (State Farm Fire & Casualty Co., Policy No. 98-CW-8146-3)

Home was destroyed by wind damage prior to any flooding. Winds blew off roof shingles, doors, windows and exterior siding. Subsequently, flood waters rose to approximately 24 inches in the home, causing some damage (though substantially less than policy limits).

Flood ins. paid: $82,000 (policy limits)
Flood damage: $27, 000

b. Jane Doe 2, 4900 Alsace St., New Orleans, LA 70129 (American National Property & Casualty Insurance Co., Policy No. 17-KY24-794-2)

This was a four-plex residential structure that was severely damaged by wind and blowing rain. The roof shingles and sheathing were badly damaged by wind, and most of the windows were blown out. Driving rain penetrated the roof, windows and damaged plumbing vents in amounts sufficient to ruin both floors of the building and its mechanical systems. ***There was no flooding by rising waters in any of the four units.***

Flood ins. paid: $96,000 (policy limits)
Flood damage: $0

c. Jane Doe 3, 4910 Alsace St., New Orleans, LA 70129 (American National Property & Casualty Insurance Co., Policy No. 17-KY24-793-4)

This was a four-plex residential structure that was severely damaged by wind and blowing rain. The roof shingles and sheathing were badly damaged by wind, and most of the windows were blown out. Driving rain penetrated the roof, windows and damaged plumbing vents in amounts sufficient to ruin both floors of the building and its mechanical systems. ***There was no flooding by rising waters in any of the four units.***

Flood ins. paid: $96,000 (policy limits)
Flood damage: $0

d. Jane Doe 4, 4920 Alsace St., New Orleans, LA 70129 (American National Property & Casualty Insurance Co., Policy No. 17-KY24-792-6)

This was a four-plex residential structure that was severely damaged by wind and blowing rain. The roof shingles and sheathing were badly damaged by wind, and most of the windows were blown out. Driving rain penetrated the roof, windows and damaged plumbing vents in amounts sufficient to ruin both floors of the building and its mechanical systems. ***There was no flooding by rising waters in any of the four units.***

Flood ins. paid: $95,000 (policy limits)
Flood damage: $0

e. Jane Doe 5, 4870 Alsace St., New Orleans, LA 70129 (American National Property & Casualty Insurance Co., Policy No. 17-KY24-791-8)

This was a four-plex residential structure that was severely damaged by wind and blowing rain. The roof shingles and sheathing were badly damaged by wind, and most of the windows were blown out. Driving rain penetrated the roof, windows and damaged plumbing vents in amounts sufficient to ruin both floors of the building and its mechanical systems. ***There was no flooding by rising waters in any of the four units.***

Flood ins. paid: $96,000 (policy limits)
Flood damage: $0

f. Jane Doe 6, 13075 Chateau Ct., New Orleans, LA 70129 (State Farm Insurance Co., Policy No. 18-CJ-7866-8-F)

Strong winds blew off roof shingles, felt, and turbine vents. Soffit and fascia were damaged by strong winds and driving rains. Wind and driving rain caused substantial damage to the home's interior and contents. Subsequently, flood waters rose to approximately 2 feet in the home, causing some damage (though substantially less than policy limits).

Flood ins. paid: $70,000 (policy limits)
Flood damage: $27, 000

g. Jane Doe 7, 5118 Spain St., New Orleans, LA 70126 (Allstate Insurance Co., Policy No. 031410279)

Winds and driving rains destroyed the house by blowing off the asbestos roof shingles, a door, windows, soffits and fascia. All substantial damage occurred prior to the arrival of flood waters. Flood waters rose to approximately 6 feet in the home, causing some damage (though substantially less than policy limits).

Flood ins. paid: $100,000 (policy limits)
Flood damage: $28, 000

h. Jane Doe 8, 4769 Francisco Verrett Dr., New Orleans, LA 70126 (Allstate Insurance Co., Policy No. 0180153487)

Home was destroyed by wind damage prior to any flooding. Winds and driving rain blew away roof shingles, a glass door, and several windows, destroying the interior of the house and contents prior to the flood. Subsequently, flood waters rose to approximately 3 feet in the home, causing some damage (though substantially less than policy limits).

Flood ins. paid: $64,000 (policy limits)
Flood damage: $25, 000

i. Jane Doe 9, 4940 Sherwood Drive, New Orleans, LA 70128 (Allstate Insurance Co., Policy No. 0045711453)

Home was destroyed by wind damage prior to any flooding. Strong winds blew off roof shingles, doors, windows and exterior siding. Winds even severely damaged the brick and vinyl roof sheathing. Subsequently, flood waters rose to approximately 3.5 feet in the home, causing some damage (though substantially less than policy limits).

Flood ins. paid: $92,000 (policy limits)
Flood damage: $30,000

j. Jane Doe 10, 13301 Dwyer Blvd., New Orleans, LA 70129 (Allstate Insurance Co., Policy No. 910871981)

Home was severely damaged by wind prior to any flooding. Strong winds blew off roof shingles, garage doors, and the rear wall of a home-shop building attachment. Wind-driven rain penetrated in large amounts through the roof sheathing and ventilators, causing extensive damage. Subsequently, flood waters rose to approximately 8 inches in the home, causing some damage (though substantially less than policy limits).

Flood ins. paid: $72,000 (policy limits)
Flood damage: $44, 000

k. Jane Doe 11, 4621 Viola St., New Orleans, LA 70126 (Louisiana Citizens Property Insurance, Policy No. FZH 032201401)

Severe winds destroyed most of the roof shingles and sheathing, as well as the soffit, fascia, and exterior siding. Wind also blew out the windows and one door. Wind and driving rains destroyed the contents of the house prior to the flooding, including the home's walls, ceiling and insulation. Wind damage left stress cracks in the woodwork around the doors and windows. Flood waters subsequently reached the home, with a high-water mark of 3.5 feet.

Flood ins. paid: $76,000 (policy limits)
Flood damage: $37,000

l. Jane Doe 12, 4537 Viola St., New Orleans, LA 70126 (Louisiana Citizens Property Insurance, Policy No. FZH 013942907)

Severe winds destroyed most of the roof shingles and sheathing, as well as the soffit, fascia, and exterior siding. Wind also blew out the windows and one door. Wind and driving rains destroyed the contents of the house prior to the flooding, including the home's walls, ceiling and insulation. Flood waters subsequently reached the home, with a high-water mark of 36 inches.

Flood ins. paid: $63,000 (policy limits)
Flood damage: $37, 000

m. Jane Doe 13, 117 Lighthouse Point, Slidell, LA 70458

Flood ins. paid: $250,000 (policy limits)
Flood damage: approximately $70,000

n. Jane Doe 14, 112 Lighthouse Point, Slidell, LA 70458

Flood ins. paid: $214,500 (policy limits)
Flood damage: approximately $70,000

o. Jane Doe 15, 133 Santa Cruz Ct., Slidell, LA 70458 (Allstate Insurance Co., Claim No. 5114716952-1)

Severe winds caused extensive damage to both floors. The entire roof of the two-story house had to be replaced.

Flood ins. paid: $135,000
Flood damage: $26,000

p. Jane Doe 16, 128 Santa Cruz Ct., Slidell, LA 70458-8805 (Allstate Ins. Co., Claim No. 180464984)

Flood ins. paid: $121,000
Flood damage: $30,000

q. Jane Doe 17, 7607 Vanderkloot Ave., New Orleans, LA 70127-1649 (Fidelity National Property & Casualty #17-2510116994-0)

Severe winds blew off roof shingles, felt, the turbine roof vent, and the soffit and fascia. Several windows were blown out. Wind-driven rain penetrated in and around doors and windows. The house and contents were destroyed by wind and wind-driven rain prior to the arrival of any flood water.

Flood ins. paid: $75,000
Flood damage: $32,000

r. Jane Doe 18, 2701-2703 S. Miro Street, Nola, LA 70125 (Fidelity National Ins. Co. #99-02108507-2004)

Dwelling was a total loss. The slate roof tiles were blown away, felt and sheathing were damaged; windows were blown out and exterior siding was damaged. Wind-driven rain penetrated the roof, broken windows, siding and damaged plumbing vents. The dwelling was in total ruin prior to arrival of any flood water.

Flood ins. paid: $25,000
Flood damage: $14,000

s. Jane Doe 19, 2705-2707 S. Miro Street, New Orleans, LA 70125 (American Reliable Ins. Co. of Scottsdale, Ariz., #1961520869)

Flood damage was incidental to the wind-driven rain destruction. Slate roof tiles, felt, sheathing, plumbing vents, siding and windows were blown away. Rain penetrated the damaged roof, broken windows, and siding. The house was a total loss prior to any flood waters arriving.

Flood ins. paid: $25,000
Flood damage:$18,000

t. Jane Doe 20, Ha Thi, 11405 South Tanner David Drive, Nola, LA 70128 (Allstate Ins. Co. #1805714779)

This home was under construction and nearly finished. Severe winds blew the shingles, felt and sheathing off and blew out several windows. Wind driven rain penetrated the damaged roof, the broken windows, damaged fascia and soffits, roof vents and plumbing vents long before flood waters entered the dwelling. Flood water subsequently entered the home with a high-water mark of 3.5 feet.

Flood ins. paid: $195,000
Flood damage: $24,000

u. Jane Doe 21, 1938 France Street, New Orleans, LA 70117 (Allstate Insurance Co. #Unknown)

Roof shingles, felt, roof vents, soffits, fascia and windows were blown away prior to arrival of flood water. The interior and contents were destroyed by wind and rain. Flood waters subsequently entered the home, with a high-water mark of 12 inches.

Flood ins. paid: $50,000
Flood damage: $38,000

v. Jane Doe 22, 2625 & 2627 General Pershing, Nola, LA 70115 (Fidelity National Property & Casualty #17 2510213116 00)

Building was a total loss. Slate roof tiles were blown off by wind-driven rain; felt, roof vents, soffit and fascia were blown away. Windows and siding were blown away by the storm. Wind-driven rain penetrated the doors and windows which were damaged by the wind and rain. The building and contents were destroyed prior to the arrival of any flood waters.

Flood ins. paid: $250,000
Flood damage: $72,000

w. Jane Doe 23, 5831 Winchester Park Dr., Nola, LA 70128 (Allstate Insurance Co. #5114299918)

Although water rose as high as 3.5 feet inside the house, the damage (a total loss) was caused by wind and wind-driven rain. Roof shingles, sheathing, and felt were blown completely away by severe winds. Plumbing vents, soffits, and fascia were blown off. There was damage to the exterior siding and doors and windows were blown out. The dwelling and contents were destroyed by wind and rain prior to the arrival of any flood water.

Flood ins. paid: $125,000
Flood damage: $40,000

VI. FRAUD IN CONNECTION WITH THE WRITE-YOUR-OWN NATIONAL FLOOD INSURANCE PROGRAM
(Count I)

22. Plaintiff/relator Branch Consultants realleges and incorporates by reference the allegations made in the preceding paragraphs of this Complaint.

23. This is a claim for treble damages and forfeitures under the Federal FCA, 31 U.S.C. §§ 3729-33.

24. Through the acts described above and otherwise, each defendant knowingly presented and/or caused to be presented to the Government materially false and fraudulent claims, records, and statements, which also omitted material facts, in order to induce payments by the Government under NFIP.

25. Through the acts described above and otherwise, each defendant knowingly made, used and/or caused to be made or used materially false records and statements, which also omitted material facts, in order to induce the Government to pay false and fraudulent claims under NFIP.

26. Through the acts described above and otherwise, defendants knowingly made, used, and caused to be made or used materially false records and statements to conceal, avoid, and/or decrease their obligation to repay money to the United States Government that they improperly and/or fraudulently received. Defendants also failed to disclose material facts to the United States Government which would have resulted in substantial repayments by them to the Government.

27. The Government, unaware of the falsity of the records, statements, and claims made, submitted or caused to be submitted by the defendants—or of the defendants' failure to disclose material facts that would have reduced Government obligations—paid for claims which would not have been paid if the truth had been known.

28. By reason of these false records, statements, claims, and omissions, the Government has been damaged in the amount of at least hundreds of millions of dollars.

VII. JURY DEMAND

29. Pursuant to Rule 38 of the Federal Rules of Civil Procedure, plaintiff/relator Branch Consultants hereby demands trial by jury.

VIII. PRAYER

30. Plaintiff/relator Branch Consultants prays for judgment against each of the defendants as follows:

a. that the defendants cease and desist from violating the FCA;

b. that the Court enter judgment against the defendants in an amount equal to three times the amount of damages the United States has sustained as a result of the defendants' actions, as well as a civil penalty against each defendant of $11,000 for each and every violation of 31 U.S.C. § 3729;

c. that the Court award Branch Consultants the maximum amount allowed pursuant to 31 U.S.C. § 3730(d);

d. that the Court award Branch Consultants all costs and expenses of this action, including attorneys' fees; and

e. that the Court award the United States and Branch Consultants all such other relief as it deems just and proper.

Respectfully submitted,

KANNER & WHITELEY, L.L.C.

By: _____

Allan Kanner
701 Camp St.
New Orleans, LA 70130
Telephone (504) 524-5777
Fax (504) 524-5763

Attorney for Plaintiff/Relator

CERTIFICATE OF SERVICE

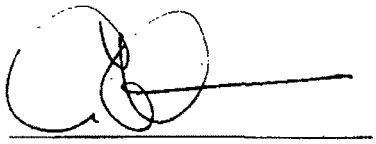
This is to certify that on August 2, 2006, a true and correct copy of this Complaint was properly served on the United States Attorney General and the United States Attorney for the Eastern District of Louisiana as indicated below and was not served on Defendants pursuant to the mandate of 31 U.S.C. § 3730(b).

VIA CM RRR and FEDERAL EXPRESS

Attorney General Alberto R. Gonzales
United States Attorney General
United States Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

VIA HAND DELIVERY

United States Attorney Jim Letten
500 Poydras Street
Room B210
New Orleans, LA 70130



The Times-Picayune

Same house. Same repairs. Same insurer. Why different prices?

Evidence suggests Allstate pays far more for flood repair than for wind damage. The reason? The government picks up the flood tab, and the company minimizes its own payout.

Sunday, May 20, 2007

By Rebecca Mowbray

Something about the insurance settlement on the Slidell townhouse seemed fishy to Chris Karpells, a prospective buyer who would be collecting the insurance money as part of the deal.

As he pored over the fine print, what caught Karpells' eye was this: Allstate seemed to have two different ways of pricing the damage repair costs, depending on whether the damage at 286 Marina Drive was chalked up to flooding or wind.

If Allstate attributed the damage to wind or rain, for example -- putting it on the hook for payment under the customer's homeowner policy -- the company priced the cost of removing and replacing the drywall at 76 cents per square foot. But if the damage was blamed on storm surge or flooding, the estimated cost of removing and replacing the drywall more than quadrupled, to $3.31 per square foot.

"On my best day, I couldn't get my client paid that much for Sheetrock. It would almost be misrepresentation or fraud," said Karpells, a registered public insurance adjuster as well as a real estate investor. "What the hell's the difference between wind Sheetrock and flood Sheetrock?"

A key difference between flood Sheetrock and wind Sheetrock is this: Allstate must pay for damage covered by its homeowner policy. But damage blamed on flooding is covered by the National Flood Insurance program, set up by the federal government and subsidized by taxpayers. And who decides which policy covers which damages? As with 96 percent of flood policies these days, it is the private insurer, in this case Allstate.

Drywall wasn't the only construction material cost that suddenly skyrocketed when Allstate was assigning the damage to the flood insurance program, Karpells noted.

The cost to recarpet the master bedroom, bathroom, loft and stairwell -- upstairs spaces that hadn't flooded and therefore were covered under the homeowner policy -- was pegged by Allstate at $23.48 a square foot. But when it came to replacing the same carpet in downstairs areas covered by the flood policy, Allstate set the price at $28.43, a 21 percent jump.

And so it went: For texturizing and repainting upstairs walls, Allstate set costs at 80 cents a square foot. The cost to the government program for apparently identical work downstairs: $1.15 per square foot, a difference of more than 40 percent.

Karpells said that, in his work as a public adjuster, he has seen the dual pricing on almost every Allstate adjustment that lists the damage line by line. And from his experience, Allstate is the only company that's doing it, said Karpells, a third-generation carpenter from Massachusetts who moved to Slidell several years before Katrina hit. Karpells said he believes that "someone is saying, 'On a flood policy, we use this database. On a wind policy, we use this database.' They're front-loading all the money on the flood policy."

Karpells is not alone in his suspicion that Allstate is gouging the government in order to minimize its own exposure to post-Katrina repair costs -- a charge Allstate flatly denies.

"Our firm position is that there are not any discrepancies in the rates charged," said Mike Trevino, a spokesman for Allstate. "The component prices reflect current market conditions. And they are the same for wind and flood."

Cindy Montgomery, a public adjuster from LaPorte, Texas, said she has seen the dual pricing in numerous Allstate cases in St. Tammany, Orleans and St. Bernard parishes and on the Mississippi Gulf Coast.

"I ended up with probably a hundred of these," said Montgomery, who is with Anchor Mitigation and Proof of Loss LLC. "Seventy-seven cents was nowhere near reality, and they knew it. I told them, and hundreds of other adjusters told them."

And the dual price list for repair costs has not been the only method of adjustment that lets Allstate be more generous with the public's money than its own.

Sometimes almost the entire burden is passed to the flood program. Down the street from the townhouse Karpells' business partner bought, for example, is Guy Smith's unit at 1546 Marina Drive: an almost identical townhouse with Allstate coverage and similar damage.

Even though both had flooded to the same depth, 42 to 48 inches, the financial burden at 1546 Marina Drive was tilted even more heavily to the federal insurance program, saving Allstate money. Smith was offered $170,927 for flood damage, while Allstate agreed to shoulder only $20,172 for roof and upstairs damage.

Indeed, in a one-page summary that contained no breakdown of costs or damages, Allstate's adjuster had declared that the appropriate response to damage at 1546 Marina Drive was to "replace" the three-story building, even though only the ground floor flooded.

"In my wildest dreams, I couldn't submit something like that and get it paid," Karpells said. "It's just so nonreflective of the damage that it's bizarre. The building was not destroyed. It was not a total loss."

Karpells thinks the flood damage at Smith's unit was probably about $80,000 to $85,000. Smith, a New Orleans firefighter, agrees that the unit wasn't a total loss. He was able to repair the damage and has been living in his townhouse since last September.

More disturbing still was the experience of Allstate customers Robert and Merryl Weiss, a Slidell couple who eventually took Allstate to court. As part of their flood insurance claim, Merryl Weiss drew up a handwritten list of damaged household contents, mostly fishing equipment. Her claim came to $38,848.35.

During depositions taken in connection with the litigation, they discovered that on the contents list submitted by Allstate for payment under the Weisses' flood policy, the value of the loss billed to the federal program had soared to more than $139,000. Fishing gear was nowhere on the list, but things had been added that the Weisses didn't even own, including furs, jewelry and the like.

"When Allstate pays a claim under a flood policy, they are using the checkbook of the United States Treasury. When they pay a claim under their homeowners policy, they are using the Allstate checkbook. For every dollar paid out of the federal treasury under flood, Allstate takes a credit and keeps a dollar. Essentially Allstate is profiting at the expense of the American taxpayer," Weiss attorney John Denenea said.

'It's apples to apples'

Allstate's Trevino declined to discuss the specifics of the claim on Karpells' townhouse, but said that the cost of repairs changes over time, and the cost of repairing one room versus another can vary, depending on how the damage occurred.

"The cost to repair wet drywall versus dry drywall is different. The cost to repair carpet from one room to carpet of another room may be different because you may have different quality carpet from room to room," Trevino said. "You can have different methods and approaches regarding paint. In one room, you may have one coat of paint, but in another room, you may need more than one coat of paint depending on the color."

Trevino further noted that public insurance adjusters, people who are hired to represent consumers after disasters to make sure they're paid properly, have an agenda.

Karpells rejected Trevino's insinuation that his profession as public adjuster was a factor in the dispute. The adjustments, he noted, were done for the previous owner of the townhouse at 246 Marina Drive. No public adjuster -- with or without an agenda -- was involved.

Moreover, Karpells argued, market fluctuations in repair costs couldn't account for the differences between prices on the flood and homeowner adjustments. They were done within two months of each other, too short a time for them to have been so extreme.

As for Trevino's suggestion that materials used upstairs might have been of different quality than those used downstairs: Not so, Karpells said. The carpet was the same on all floors, and the texture and paint on the walls was identical throughout the house.

"It's apples to apples," Karpells said. "The facts speak for themselves."

Craig Berthelot, vice president of the Home Builders Association of Greater New Orleans and owner of Berthelot Construction Services, which renovates and repairs storm-damaged homes in the New Orleans area, said that the real price for replacing drywall is between the prices that Allstate calculated.

Without the tear-out portion of the job, it costs about $2 to $2.50 per square foot to replace drywall, he said. The $3.31 billed to the flood program for tearing out and replacing drywall is high but more realistic than Allstate's 76 cents on the homeowners policy, Berthelot said.

The Katrina memo

Allstate is the nation's largest publicly held insurer of homes, autos and other personal risks. But when Katrina hit, the policies it had written in Louisiana were not backed up by reinsurance, a corporate policy that kicks in to cover an insurer's losses beyond a certain level in the event of a catastrophe like a hurricane.

Reinsurance paid for an estimated 45 percent of U.S. losses incurred by insurers as a result of the 2005 storms, according to the Insurance Information Institute, but Allstate was on the hook for the entire cost of damages covered by its Louisiana customers' homeowner policies. By the end of 2006, it had paid $1.4 billion in homeowners claims in Louisiana, where it is, after State Farm, the state's second-largest residential insurer.

Trevino said that reinsurance wouldn't have saved the company much money, and having to pay out of its own pocket didn't affect the company's generosity in handling claims. Nor did it inspire the company to slough off damages onto flood policies, he said.

Facing at least 200,000 claims after Katrina, the largest disaster it had confronted, the National Flood Insurance Program looked for ways to expedite payments to policyholders.

On Sept. 21, 2005, three weeks after the storm, acting flood program Director David Maurstad, who consulted regularly with insurers after the storm, issued a memo expediting the processing of flood claims.

The memo waived the requirements that customers prove their losses and instructed the insurance companies to pay the flood policy limits if the home was washed off of its foundation or if the home was in "standing water" for "an extended period of time."

Ed Pasterick, a senior adviser to the flood program, offered this explanation: "What we didn't want people to do was be penalized while we were determining if it was wind or water. He (Maurstad) just made a decision that he didn't want people to have suffer because of it."

The memo is widely credited with getting money into disaster victims' hands quickly and is upheld as an example of business and government working together to handle a challenging situation.

In hindsight, others have begun to wonder if it didn't send a signal to the private insurance industry that the federal treasury was their cookie jar and that no one would be looking if insurers helped themselves at the public's expense.

As the flood program went broke after Katrina, requiring a massive taxpayer bailout, U.S. Rep. Gene Taylor, D-Miss., began to ask pointed questions about how the rules got eased so quickly and in ways that were so advantageous to the private insurers. After all, FEMA, the agency that runs the flood program, was also the agency that had proved too hopelessly dysfunctional to make the adjustments that might have smoothed the flow of desperately needed public money to prostrate local governments.

"Our experience is that these guys didn't do anything to speed up the program anywhere else. Why did they do it here?" asked Brian Martin, a Slidell native who is Taylor's policy director. "I suspect that the idea came from the insurance companies."

Taylor's hunch is that the flood program eased its rules at the behest of the private insurers, who stood to benefit directly if the lion's share of losses could be laid off on the flood program, rather than homeowner policies.

"They get to go right out there and give them a check. It's from the federal government," Martin said. "It gives the homeowner something so that there's not huge pressure on the insurance company to pay something now.

"The flood insurance program made it easy for a few of the insurance companies to manipulate those claims to put it all on flooding," Martin said. "The taxpayers pick it all up."

"It was a very bad idea," said Bob Hunter, who oversaw the federal flood insurance program in the Ford and Carter administrations and now is a consumer advocate as director of insurance at the Consumer Federation of America. "It allowed these insurance companies to come in and say, 'This was all flood damage,' and hand out a check without any analysis of whether it was wind damage."

Officials bewildered

But even Hunter, skeptical as he was, didn't imagine that a company would develop two different price lists for nearly identical repair work. He thought the insurance companies would stop at trying to argue that damages were due to flooding, rather than wind. Indeed they have in a number of well-publicized lawsuits -- notably including U.S. Sen. Trent Lott's fight to recover more money from the homeowner policy that covered his destroyed waterfront home in Pascagoula, Miss.

The dual price lists are something else again. "I had no idea they would be so blatant," Hunter said.

FEMA also expressed bewilderment over the idea of charging government and private insurers different prices, when told about practices in the New Orleans area.

"I don't have an explanation for that," said Tim Johnson, senior insurance examiner on the claims section at FEMA. "If that's what they say is happening, I would love to see it. The overpayment surely does affect me."

The lack of uproar from customers is easier to understand. Essentially, claims adjustment, when both flood and homeowner policies are in play, is a zero-sum game. The customer wants insurance to cover the cost of repairing or replacing the house and has little reason to care whether the federal program or the private insurer foots the bill.

Smith, the firefighter who owns 1546 Marina Drive, said Allstate told him not to worry about whether the damage was attributed to wind or flood, that it would all come out in the wash. "It was basically, 'Look at the entire package, don't look at the wind claim for what it is, just look at the entire package,' " Smith said. "It was pretty clear."

The Times-Picayune

Inflated flood claim turns up at trial
Allstate contents list is news to owners
Sunday, May 20, 2007
By Rebecca Mowbray

Fishing poles and fancy furs weren't the issues at trial. Instead, Merryl and Robert Weiss had gone to court to fight the contention by their insurer, Allstate, that they were entitled to only a pittance under their homeowner policy because flooding, not wind, was largely responsible for the destruction of their home on Slidell's Treasure Isle.

But about a month before trial, Merryl Weiss realized there was something wrong with the payment for household contents that they had received on their obliterated Slidell home.

In making the claim under their taxpayer-subsidized National Flood Insurance policy, Weiss had given Allstate a handwritten list of belongings from the ground floor of the three-story house -- most of it rods, reels and other gear owned by her husband, a retired doctor who is a die-hard sport fisherman with a charter boat license. She valued the lost contents at $38,848.35.

But as documents were being flashed in front of her for identification, Weiss was shown a typed property-loss worksheet totaling $139,562. The inventory listed a formal living room, dining room, kitchen, living room/great room/game room, an office, a foyer, bathrooms, five bedrooms, a garage/shed, utility room, clothes, miscellaneous items and categories labeled "DVDs/VCRs/records" and "jewelry, furs, memorabilia, etc."

Weiss didn't generate the list, and never submitted a contents list for the upstairs rooms of the home to Allstate before the flood contents check was cut. Indeed, she said she doesn't own any furs. But Allstate submitted the bill to the National Flood Insurance program, which paid the policy's limit of $100,000 for contents after depreciation and a deductible were taken out.

"I never even claimed that we had any of this stuff," Weiss said in her deposition. "I did not write this, and I did not write this," she said, pointing to items on the list.

Mysterious paperwork

At last month's trial, the Weisses were awarded a $2.8 million judgment against Allstate for failing to properly adjust the claim, an award that the insurer is appealing. That settled, at least temporarily, a fight over wind versus flood damage. But the unanswered question was how the Weisses' contents claim got inflated by $100,714. No one seemed to have an explanation.

Not Mike Wells, the outside adjuster employed by Allstate to handle the claim. He testified that he had given the Weisses' handwritten list of fishing equipment to Allstate.

Not Mung Hatter, who worked for four months processing Allstate claims before landing her current job at Beau Rivage casino on the Mississippi coast. Hatter testified that she simply put the finishing touches on the claim using the numbers the company gave her before supervisors signed off on the settlement and it was mailed to the flood program for payment.

'Quality control measures'

On the fourth day of the trial at the federal courthouse on Camp Street, Paul Tracey, field operation's manager for Allstate's catastrophe unit, was asked point blank by Weiss attorney Richard Trahant how the contents figures grew.

"Do you have any idea how those numbers increased from $38,000 to $139,000?" Trahant asked.

Tracey said he could explain how the process works, and he hastened to say that Allstate handled claims honorably.

"We . . . have quality control measures under our policy, under our process, to ensure that the evaluations are being done correctly and accurately. The federal government also reinspects our work for the National Flood Insurance Program," Tracey said.

But that didn't explain the inflated and imaginative contents list. To counter the implication that there was something underhanded going on with the list, Allstate lawyer Judy Barrasso asked Tracey what was to prevent Allstate from dumping costs onto the flood policy so as to spare Allstate the expense of a settlement under the homeowner policy.

"In handling these claims, what's to stop Allstate from just putting all of somebody's claim as a flood loss instead of a wind loss?" Barrasso asked.

"Well, number one, we don't do that. . . . If there's damages from wind, we pay it under the wind; if there's damages from flood, we pay it under the flood," he responded.

Destroyed by tornado

The Weisses said they limited their contents claim under the flood policy to the ground floor of their house because storm surge estimates suggested that the upper two floors were above the water line. Based on early conversations with their adjuster and an engineer who visited the house in November 2005, they believed their house was destroyed by a tornado.

In trial testimony, Hatter said the inflated contents list named an Alabama contract worker as adjuster. The contract worker could not be found for the trial and efforts by The Times-Picayune to contact her were unsuccessful. Hatter said that after getting the list from the contract worker, she typed up the claim and circulated it for approvals from higher-ups at Allstate before sending it to the flood program for payment.

Hatter testified that Allstate had programs in place to monitor what lower-level contract workers were doing with computerized claims. In his testimony, Tracey affirmed that everything Hatter would have done went up the ladder and was approved by someone at Allstate before it was submitted by the government.

Didn't call Allstate

At deposition, Allstate attorney Meredith Cunningham asked Weiss why she didn't notice that they were being overpaid by the flood program and why they didn't say anything about it when they realized the discrepancy.

"When you received a check for $100,000 for the contents . . . did you ever ask anybody at Allstate why am I getting an extra, you know, tens of thousands dollars more than I intended to get on this coverage?" Cunningham asked.

Weiss said that in the barrage of paperwork after the storm, she didn't read everything in the envelope that came with the checks.

"I knew it would all come out in the end one way or another. I mean, why would I call Allstate and say, 'Wait, you gave me too much money here,' when I'm waiting on another . . . $600,000?" Weiss said. "I assumed that in the end, all of this would be evened out. I never asked for more than I thought we should have."

The Times-Picayune

Insurers bilked flood program, suit says

Adjusters say wind claims underpaid

Thursday, May 31, 2007
By Rebecca Mowbray

A newly unsealed whistleblower lawsuit claims that at least eight major insurance companies in Louisiana and their adjusters are ripping off the federal government by overbilling the National Flood Insurance Program for Hurricane Katrina flood damage while stiffing homeowners on wind damage payments under their homeowners insurance policies.

In the suit, a group of former insurance adjusters, identified only as the Georgia company Branch Consultants LLC, say they have reinspected 150 properties with flood and wind damage. In all cases, private insurance companies overcharged the federal flood program for storm damage while they underestimated wind damage.

"Every single one of them," said Allan Kanner, a New Orleans attorney representing the insurance and construction experts as they pursue what they say is a violation of the False Claims Act on behalf of the federal government. "There's a pattern here."

In one striking example, the suit claims that owners of a group of fourplex apartments in eastern New Orleans were compensated for flood damage with taxpayer money even though they experienced no flooding. Each building in the complex was paid only a pittance for severe wind damage on its regular property insurance policies.

American National Property & Casualty Insurance Co., or ANPAC Louisiana Insurance Co., paid the owner of several buildings in the Versailles Gardens subdivision on Alsace Street about $95,000 in flood damages, or about half the value of each property's individual $200,000 flood policy, even though no floodwaters got inside the buildings.

In each unit, roof shingles and sheathing were badly damaged by wind, most of the windows were blown out, and enough driving rain got inside to ruin both the floors of the apartments and their mechanical systems, according to the suit.

But American National paid $40,000 or less per building from its own coffers for wind damage that Branch estimates should have been more than $250,000 at each location, resulting in the property owner being undercompensated for hurricane repairs.

American National, based in St. Louis, did not return several phone messages seeking comment.

Other insurance companies named in the suit are Northbrook, Ill.-based Allstate Insurance Co.; Bloomington, Ill.-based State Farm Fire and Casualty Co.; Boston-based Liberty Mutual Fire Insurance Co.; Jacksonville, Fla.-based Fidelity National Insurance Co. and Fidelity National Property and Casualty Insurance Co.; Arizona-based Scottsdale Insurance Co.; and St. Paul, Minn.-based St. Paul Travelers Cos., which changed its name since the suit was filed to the Travelers Cos. Inc.

The suit also names five subcontractors that provided adjusters to the insurance companies after Katrina: Mobile, Ala.-based Pilot Catastrophe Services Inc.; Atlanta-based Crawford & Co.; Indianapolis, Ind.-based NCA Group Inc.; and Niceville, Fla.-based Simsol Insurance Services Inc.

Kanner says other companies could be added as the suit develops.

Although companies were scheduled to be served copies of the lawsuit last week, defendants said they had not yet seen copies of the suit, which has been under seal in U.S. District Court in New Orleans since it was filed in August 2006.

State Farm and Allstate, Louisiana's largest residential insurers, each expressed confidence in their claims-handling practices.

"We feel that we've appropriately handled claims arising out of Katrina and that we followed NFIP and FEMA guidelines with regards to expediting flood claims," State Farm spokesman Fraser Engerman said.

"We have not yet received a copy of the suit. Nonetheless, Allstate remains confident in its claim settlement practices following Hurricane Katrina and is committed to resolving all claims fairly and appropriately," said Allstate spokesman Michael Trevino.

Pilot Catastrophe Services and Crawford & Co. adjusters each said they were unable to comment because they hadn't seen the suit. The rest of the companies did not respond to queries for comment.

The burden of claims

The lawsuit, unsealed by Judge Peter Beer, alleges that the defendants "defrauded" the U.S. government and violated the False Claims Act by knowingly submitting fake Katrina damage bills to the government for payment. While insurance companies "maxed out or nearly maxed out" flood policies from the Federal Emergency Management Agency, they "substantially underpaid" payments for wind damage at the same properties.

"Rather than follow in good faith the streamlined procedures that FEMA had set up, defendants instead systematically adjusted, paid and submitted reimbursement claims to NFIP regarding losses that obviously should not be covered by flood policies. They did so in massive quantities," the complaint reads. "Defendants defrauded NFIP by misattributing wind damage and other non-flood losses to the flood policies underwritten by the Government rather than correctly attributing such losses to causes that are covered by their homeowners policies."

The whistleblower suit is the strongest and broadest compilation of evidence to date that insurance companies may be shifting the burden of claims that they should be paying onto taxpayers through the flood program.

Two weeks ago, Slidell public adjuster Chris Karpells of YourAdjuster.com LLC disclosed that Allstate Insurance Co. charged inflated prices to the government for common rebuilding jobs while charging itself reduced prices for the same work at the same house.

The scope of the suit is potentially huge. The whistleblowers, who remain anonymous while they try to document insurance payouts and actual damage on more properties, say they have found an average overpayment of 66 percent on flood policies.

If the Branch Consultants' 66 percent overpayment statistic holds true across the $14 billion that the National Flood Insurance Program paid in Louisiana from Katrina and Rita flood damage, it would mean that insurance companies bilked the flood program for as much as $9.24 billion, or more than the total cost of the Road Home grant program.

Flood insurance is provided by the federal government and is subsidized by taxpayers, but 96 percent of all flood policies are sold and administered by the private insurance companies that often sell people their homeowners insurance coverage.

Faced with 240,000 claims after Katrina, the flood program removed hurdles to adjusting claims in an effort to get money into disaster victims' hands quickly. Many people now question whether that well-intentioned move unlocked the federal treasury's vault for the insurance industry, which then could freely charge the federal government for storm damage simply by attributing it to rising water with little documentation. While insurance companies pacified homeowners with flood money, the theory goes, they held the line on paying for damage from wind or wind-driven rain that comes out of their own bank accounts.

Ed Pasterick, senior adviser to the National Flood Insurance program, said he's skeptical about the potential scope of any wind/water allocation problem.

After Tropical Storm Isabel flooded parts of Maryland and Virginia in 2003, Pasterick said, people complained that they didn't receive adequate compensation from their flood policies. In response, the flood program reopened 24,000 claims, Pasterick said, but the huge effort to readjust the claims turned up no systemic evidence of problems.

Still, Pasterick said, FEMA, which oversees the flood program, takes seriously the concerns of the Branch whistleblowers and will look into their allegations.

"If those figures are accurate, we've obviously got a problem," Pasterick said.

Under the radar

Federal officials from the Department of Homeland Security, FEMA, the Federal Bureau of Investigation and the U.S. Attorney's Office in Baton Rouge were briefed on the suit in November while it was under seal and before insurance companies knew it existed.

David Dugas, U.S. attorney for the Middle District of Louisiana in Baton Rouge, said his office fielded the complaint with the Civil Division of the Department of Justice in Washington.

When a "qui tam action," or a whistleblower suit, is filed by a private individual on behalf of the government, it is automatically placed under seal for a period of time so that public officials have a chance to investigate the evidence and decide whether they want to take it over.

So far, the answer is no, which is why the complaint was made public, but Dugas said he retains the right to step in at any time.

"We have at this point declined to intervene, but we will continue to closely monitor the litigation," Dugas said.

Jim Letten, U.S. attorney for the Eastern District of Louisiana in New Orleans, said he could not say why Dugas' office in Baton Rouge, and not the New Orleans office, handled the complaint.

For now, Kanner and the Branch consultants will press the case on FEMA's behalf.

"I don't believe the federal government has decided to ignore it," Kanner said. "They can always jump back in. We thought, on a public interest view, that it ought to be pursued."

If whistleblowers are successful in pursuing the suit without the U.S. attorney's intervention, they could be awarded as much as 30 percent of the proceeds if the suit is victorious. If the U.S. attorney's office decides later to take over the investigation and the effort is successful, the whistleblowers' take is reduced to 15 percent to 25 percent of the proceeds, Dugas said, because the government is the one doing the heavy lifting.

Under the False Claims Act, anyone who knowingly submits fake bills to the government is liable for three times the amount of damages sustained by the government, according to the Branch suit. There is also a civil penalty.

Homeowners not penalized

Although many people in the New Orleans area may have been overpaid for flood damage while being shorted on wind payments, FEMA says homeowners do not have to worry about losing what they've gotten if they speak up.

"If the situation is being paid too much on the flood claim and not enough on the wind claim, the homeowner is not going to get penalized," Pasterick said. "We would simply readjust it and require that the company pay the appropriate amount under the wind policy."

Under normal circumstances, Pasterick said, FEMA would ask anyone who was overpaid by the flood program to return the money. But in this case, homeowners would not risk losing their flood money, because they're not the beneficiaries of an accidental windfall; they're pawns in a possible flood-wind allocation scam. "They should make it clear that they have both wind and flood coverage and they felt they were overpaid. They should make it clear that, 'I had more wind damage than was actually accounted for, and I was paid for it under flood.' "

FEMA would go after the companies for not adjusting claims properly, Pasterick said, not individual homeowners.

Under the law that governs the flood program, private companies have a clear duty to adjust claims properly. Insurance companies have a fiduciary responsibility to the federal government "to assure that any taxpayer funds are accounted for and appropriately expended" under the National Flood Insurance Program. They are also required to handle flood claims according to their "customary business practices," and adjust claims according to "general company standards and NFIP claims manuals," implying that they're required to handle flood claims in the same way they would handle wind claims.

The law also says that if there are any inadvertent delays, errors or omissions under a transaction relating to the flood program, "the responsible party must attempt to rectify that error as soon as possible after the discovery of the error and act to mitigate any costs incurred due to that error." If steps are not taken to rectify the situation, the law states, "the responsible party shall bear all liability attached to that delay, error or omission to the extent permissible by law."

Kanner, head of the insurance section at the Louisiana Association for Justice, formerly known as the Trial Lawyers Association, said he hopes that people will look at their flood and homeowners adjustments and come forward if they think they may have been overpaid on flood and underpaid on wind.

"I think at some point people will stand up and say, 'Something's got to be done about this,' " Kanner said.

All the same problems

The Branch Consultants have been collecting flood and homeowners insurance adjustment figures on houses around the area and then going to the properties to readjust the claims themselves using Xactimate, a standard adjusting software used by State Farm and many other companies.

They say their estimates err on the side of generosity to the homeowner, and they do not analyze payments for contents.

After calculating what the adjustment should have been, they analyze how the insurance company adjustments deviated from reality. Across the board, they have found overpayment on flood and underpayment on wind.

State Farm, for example, paid one Metairie homeowner $88,280 even though there was no flooding inside the home. Meanwhile, the company paid $5,379 on the homeowners policy for what Branch says is actually $110,918 in wind damage.

State Farm also paid a homeowner on the West Bank in Jefferson Parish $51,205 for eight inches of water inside the home. The flood estimate cost breakdown includes damages unlikely to have been caused by flooding, such as $7,086 for a roof, $18,418 for exterior finish, and $20,145 for rough framing.

Meanwhile, the policyholder was paid $5,768 for wind damage, but suffered $95,030 of actual wind losses, the Branch reinspection found.

Allstate paid the flood policy limits of $250,000 on a home in the Eden Isles area of Slidell that took on two feet of water, and paid the flood policy limits of $91,600 on a home in eastern New Orleans that took on three and a half feet of water. Neither estimate provides any measure of square footage or documentation of damage that would allow an auditor to know whether paying the policy limits was justified; it simply lists a total loss figure. The eastern New Orleans home sustained $71,685 of wind damage, for which the owner was paid $12,266.

Another Allstate adjustment of a property in eastern New Orleans that took on eight inches of water counted the flood damage twice.

At the beginning of the estimate, Allstate lists estimates to repair everything in the kitchen, bathroom and rest of the house below four feet, and calls the home's fixtures "better" grade even though Branch says they were only standard grade. The adjustment then goes back in and bills the flood program to remove and replace the floor in each room, even though flooring should have already been included in the tally.

While that eastern New Orleans homeowner was paid $69,000 for flood damage that should have totaled $43,847, the homeowner was paid $11,894 for wind damage that should have cost $75,529, according to the suit.

A flood policy written by Fidelity on an eastern New Orleans home insured by Louisiana Citizens Property Insurance Corp. paid the policy limits of $75,000. Although the house took on four feet of water, the Fidelity flood estimate billed the government for parts of the house that didn't need to be replaced, such as the roof, brick veneer exterior finish, framing, foundation and tile floor, which simply needed to be mopped clean, the suit alleges.

Meanwhile, the homeowner was paid $21,098 for $58,022 of wind damage.

The overpayments on the flood and mistakes in the adjustments are particularly striking, Branch says, because flood adjusters are among the best-trained in the business. To become a certified flood adjuster, according to a 2005 Government Accountability Office report, a candidate must have at least four consecutive years of full-time adjusting experience, have attended an adjuster workshop, and recertify each year.

Flood adjusters also are required to submit detailed reports and photographs to support their findings. The Branch evaluators say that in most cases, those rules still should have been in force, because FEMA's expedited flood procedures should have applied only to homes that disappeared in the storm or sat in standing water for an extended period of time.

"These kind of abuses are just unconscionable," Kanner said.

The Times-Picayune

Judge prods feds in flood insurance case

Justice Department urged to play active role in whistle-blower suit

Friday, June 08, 2007

By Rebecca Mowbray

The federal judge who unsealed a whistle-blower case last month about insurance companies allegedly overbilling the National Flood Insurance Program is demanding that the U.S. Department of Justice get involved in the case or explain itself.

The unusual move comes from U.S. District Judge Peter Beer, who unsealed a case in which a group of former insurance adjusters say that they have collected evidence that insurance companies have defrauded taxpayers by overbilling the federal flood program while underpaying claims for Hurricane Katrina wind damage to save the companies money.

Beer filed this one-sentence motion in court this week:

"The Court, on its own motion, respectfully requests the United States Department of Justice enter this case by July 9, 2007, or show cause on July 11, 2007, at 9:30 a.m., why they are not intervening in this civil action."

Beer said he was surprised to learn that the U.S. attorney's office in Baton Rouge planned only to monitor the case, which now is being prosecuted on behalf of the U.S. government by a private attorney in New Orleans representing the whistle-blowers, rather than to take it over.

"What about the good old general public? Who better to look after the interests of the public than the U.S. attorneys?" Beer said. "This is a case the government should be involved with. The United States should be right in there, and not just monitoring it, given as far-reaching and serious as this case is."

The whistle-blowers say that they've analyzed the insurance company appraisals of damage and readjusted claims at 150 properties in the New Orleans area, and they've documented that in each case, the flood claim was overpaid while the wind claim was underpaid. So far they have found that flood claims were overpaid by an average of 66 percent, meaning that the overcharging could reach into the billions of dollars, given that the flood program paid $14 billion after Hurricanes Katrina and Rita in Louisiana.

Because private insurance carriers administer federal flood insurance policies and adjust both flood and wind claims, the theory is that companies may be dumping the bills for wind damage onto the taxpayer-financed flood program to save themselves money.

Insurance companies have said they stand by their claims-handling practices.

Beer's motion was copied to U.S. Attorney General Alberto Gonzales or his deputy; Jim Letten, the U.S. attorney in New Orleans; and David Dugas, the U.S. attorney in Baton Rouge.

Although the whistle-blower suit was filed in federal court in New Orleans, Dugas' office in Baton Rouge fielded the complaint with the civil division of the Department of Justice in Washington. The U.S. attorney's office in New Orleans has said it can't say why the complaint isn't being handled locally.

Dugas was unable to be reached for comment. A spokesman in Washington said the Justice Department would have no comment at this time.

The Times-Picayune

Hearing on flood claims is today

Adjusting procedure is one of the issues

Tuesday, June 12, 2007

By Rebecca Mowbray

Immediately after Hurricane Katrina hit, the National Flood Insurance Program, under pressure from the insurance industry, took radical steps to streamline its claims handling process so it could get payouts into the hands of policyholders more quickly.

Documentation requirements were dropped. So were adjuster training requirements. And new procedures allowing adjusters to rely on satellite photos in determining a property's flood damage were rolled out.

The program's swift adjustment has been lauded for getting money into disaster victims' hands rapidly -- a noble impulse in the plodding Federal Emergency Management Agency -- and upheld as an example of how government and private business can work together to meet people's needs in a crisis.

But questions are mounting about whether insurance companies have used the program to overpay flood claims while they underpaid wind claims, thereby shifting costs that should have been borne by the private sector onto taxpayers.

Some now wonder whether those hassle-free adjustments facilitated a raid on the federal treasury by the insurance industry while FEMA, which runs the national flood program, was ill-equipped to catch it because of deficient auditing methods.

Those questions about insurance companies' handling of the flood insurance claims -- and FEMA's failure to catch alleged improprieties -- will be probed today in a hearing in Washington sponsored by the House Financial Services Subcommittee on Oversight and Investigations and the Homeland Security Subcommittee on Management, Investigations and Oversight.

Officials from the Government Accountability Office and the Department of Homeland Security's Office of the Inspector General, which are investigating how insurance companies allocated flood and wind damage, are scheduled to testify.

"Congress must ensure that every flood victim receives prompt and fair reimbursement for storm damage to their home. While the National Flood Insurance Program needs to be responsive when assessing damage and paying out claims to flood victims, it must also conduct better oversight to ensure that it's not being abused by its private insurance partners," said Rep. Christopher Carney, a Democrat from Pennsylvania who is chairman of the homeland security subcommittee.

It's happened before

Today's hearing isn't the first time FEMA's oversight of Katrina flood claims has been called into question. The GAO has twice faulted the flood program for its auditing procedures, and says that it can't sign off on the results from the expedited claims procedures because the audits weren't done from a random sample of estimates.

In a recent report, the GAO urges FEMA to improve its oversight of the flood program. "FEMA did not adopt our October 2005 recommendation that it select the claims to be reinspected from a

random sample of the universe of all closed claims," the report states. "The results of FEMA's NFIP quality reinspection program for Hurricanes Katrina and Rita cannot be projected to a larger universe than the claims adjustments sampled. As a result, FEMA is unable to determine the overall accuracy of claims settled for these flood events -- an action that is necessary to meet GAO's internal control standard."

The report says that proper auditing is especially important because Katrina and Rita involved more claims and higher payouts than ever before, as well as new procedures that must be tested for accuracy.

David Maurstad, administrator of the flood program, and other FEMA officials were not available for interviews about the development of the expedited flood procedures and the GAO findings, but the report says that FEMA accepts the GAO recommendations.

In a letter commenting on the report, FEMA says that it didn't have time to adopt the October 2005 recommendation to reinspect a random sample of claims because of its efforts to respond to Hurricanes Katrina and Rita.

While FEMA says it will start using random sampling, the agency bristled at the report's findings. "It is difficult to understand how GAO reached a conclusion that FEMA is not meeting an internal control standard without giving thorough consideration to all of the controls and processes that FEMA has in place to provide oversight of the program," the response letter reads.

Getting it moving

FEMA set the stage for how it would allow Katrina flood claims to be handled at a Sept. 7, 2005, meeting of 300 insurance company representatives, insurance agents and Gulf Coast insurance commissioners. Maurstad assured the crowd, jittery about the mammoth task of administering what eventually would become 162,065 flood claims, that he had already had conference calls with the largest insurance companies in the flooded areas and was working on emergency procedures to streamline claims-handling.

"We're going to do everything that we can to make sure from this national program that the policyholders and the citizens of these areas that are affected are going to be treated as quickly and fairly as possible, given the scope that everyone else has already talked about," Maurstad, a former insurance agent and Nebraska lieutenant governor, said at the meeting. "We're working with all the companies, the trade associations, as closely as we can. We're trying to do what we can to expedite the claims-handling process.

"I think we'll have it up and rolling pretty soon," he told participants in the meeting, which had been convened at the Atlanta Airport Marriott by then-Louisiana Insurance Commissioner Robert Wooley.

Just two weeks later, on Sept. 21, as Hurricane Rita was readying its punch to Texas and Louisiana, Maurstad's expedited flood procedures were unfurled. Those procedures removed claim documentation requirements and adjuster training requirements and allowed companies to pay a flood policy's limits if the house was gone or sat in standing water for an extended period of time.

The expedited procedures approved by the flood program after consultation with insurers also allowed companies to settle flood claims without a site visit if satellite and aerial images showed that the home disappeared in areas that suffered storm surge, or if the home sat in floodwaters and the damage was likely to have exceeded the policy limits.

In addition, FEMA waived the line-by-line adjusting that was of concern to participants in the Wooley meeting. Rather than require room-by-room, item-by-item calculation of insured losses, FEMA allowed flood adjusters with two large but unnamed insurance companies to calculate damages by measuring the square footage of each room and characterizing the building materials as high-, medium-, or low-grade, according to the GAO report.

Those two large insurance companies probably made money off of that procedure. While FEMA scaled back the fee that private companies earned for adjusting claims if satellite photos and house measurements on file made it likely that the home was a total loss, FEMA paid the same fees to companies for the easier square-foot adjustments that it paid for the detailed line-by-line adjustments.

Companies earned $750 for claims that were expedited using satellite photos but collected the full fee -- 3.3 percent of the total claim or the amount listed on a fee schedule -- when conducting square-footage adjustments, according to the GAO.

FEMA also didn't keep track of how many homes were adjusted using the square-foot method, according to the GAO report.

At the same time, FEMA loosened the adjuster training requirements to get more adjusters into disaster-stricken areas.

Under private contract

Most of the flood program is run by a private contractor, Computer Sciences Corp., which has 170 employees working on the National Flood Insurance Program to the government's 40 employees.

The California company manufactures a popular automobile claims-processing software used by Allstate, called Colossus, but maintains a wall between its private-sector and public-sector businesses.

Computer Sciences is the flood program's data bank, auditor and liaison with the insurance industry. It tracks policies, claims and damages, reconciles the financial accounts, tracks financial information for the private companies working with the flood program, looks for errors, does claims reinspections when problems arise, and trains insurance agents and adjusters.

To audit flood claims, Computer Sciences uses its judgment to select the more challenging claims for reinspection, on the theory that if the more difficult claims are handled properly, the more routine claims are probably OK as well. While that method may help to identify problems with certain types of claims, the GAO says it obscures the overall picture.

"The major limitation of this type of sampling is that the results cannot be generalized to a larger population, because there is no way to establish, by defensible evidence, how representative the sample is," the GAO says.

The report also says that FEMA doesn't generally require reports of the overall results of reinspections after floods.

FEMA says about 17,200 claims, mostly from Katrina but a few from Rita, were adjusted using the expedited procedures.

Computer Sciences reinspected 4,316 Katrina and Rita claims. When the GAO looked at a statistically valid sample of 740 of those claims, it found errors in about 14 percent of Katrina claims using regular processes, and 1 percent of Katrina and Rita claims using the expedited processes. But because FEMA hasn't done statistical sampling of claims in the past, there's no way to know whether it's high or low, so the results are inconclusive.

"Because in the past FEMA has had neither an appropriate sampling methodology nor a requirement for an overall analysis claims adjustment done after every event, we do not know how the error rates we identified compare to adjusting errors identified in reinspections of claims from other smaller flood events," the report says.

Problems with reports

It's not the first time the GAO has faulted FEMA for its auditing. In a report released in October 2005 as a requirement of the Flood Insurance Reform Act of 2004, the GAO says that its auditing work is insufficient, and says that implementing proper auditing procedures will be critical for checking claims adjustments from Katrina and Rita.

"The lack of statistically representative samples for processes to assess the accuracy of claims and adjustments limits FEMA's ability to project the results of its analyses in order to provide management information on the private sector's overall implementation of the program," the report concludes. "Without such information, the value of FEMA's monitoring processes . . . as critical internal control activities is limited."

For the 2005 report, the GAO interviewed some of the adjusters who reinspect claims for Computer Sciences Corp. An instructor in an adjuster refresher training program observed that while adjusters performed well during the 2004 hurricane season, problems were found with the measurement of rooms and the allocation of flood damage and wind damage, the report said.

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CHAIRMAN CHRISTOPHER P. CARNEY
Committee on Homeland Security's Subcommittee on Management, Investigations and Oversight

JOINT HEARING ENTITLED "NATIONAL FLOOD INSURANCE PROGRAM: ISSUES EXPOSED BY THE 2005 HURRICANES," June 12, 2007

QUESTIONS FOR THE RECORD

The Committee on Homeland Security's Subcommittee on Management, Investigations, and Oversight submits the following questions for the record. The Subcommittee appreciates your response on or no later than July 12, 2007.

Ms. Orice Williams, Director, Financial Markets and Community Investments, Government Accountability Office

1. On September 21, 2005, FEMA issued a memo, which stated, "FEMA will not seek reimbursement from the company when a subsequent review identifies overpayments resulting from the company's proper use of the FEMA depth data and a reasonable method of developing square foot value in concluding claims."[1]

    a. Was it necessary for FEMA to absolve the insurance companies of any responsibility for mistakes in order to expedite flood insurance payments to storm victims?

    We understand the intent and desire of FEMA to speed up the processing and payment of claims in the aftermath of such a terrible catastrophe. However, it is unclear whether it was necessary for FEMA to take this step to encourage the private insurance companies to use expedited claims procedures. This is not an issue that we specifically looked in our ongoing work. As we reported in our December 2006 report (GAO-07-169), about 11 percent of the Hurricane Katrina claims were adjusted using expedited procedures. While the letter hold an insurance company harmless for "overpayments resulting from the company's proper use of the FEMA depth data and a reasonable method of developing square foot value in concluding claims," it appears that FEMA could recapture any overpayments that resulted from a WYO improperly using FEMA's depth data or a method deemed not to be feasible, then FEMA could seek reimbursement.

    b. Couldn't FEMA have sped up the payment process by telling the private insurance companies adjusting flood claims to pay those that appeared to be caused by flood while leaving the final, conclusive determination for later?

[1] See "Hurricane Katrina - Flood Claim Handling Standards" W-05054, (September 21, 2005).

Such an approach would have been reasonable. This approach would also have helped ensure accountability and maintain management controls if claims were determined to be incorrect during the quality reinspection process.

c. Doesn't this policy open the door for insurance companies to push wind claims onto the NFIP – particularly where the private company adjusting the flood claim also holds the wind policy?

This policy raises questions about the oversight and internal controls FEMA uses to ensure that WYO insurance companies are properly adjusting flood claims when they are also responsible for adjusting their own wind claim. However, as written, if FEMA found that an insurer had knowingly paid a flood insurance claim for wind damages, FEMA would still have been able to seek reimbursement. Unfortunately, it would be difficult for FEMA to make such a determination as it believes that it lacks the authority to require access to the wind claim files for properties subject to both flood and wind damage.

2. In many cases, a. private insurance company who adjusts a government-underwritten flood policy also holds a wind policy that they themselves underwrite.

a. Do you believe that there is the risk for abuse or potential for conflict of interest when this scenario occurs?

There is an inherent conflict of interest when a private insurance company adjusts both the wind policy and flood policy. This stems largely from the fact that the insurer has a financial interest in the outcome of both claims. First, if the damage is attributed to wind the private insurance company is responsible for it. Second, if the damage is attributed to flood, the private insurance company is paid a percentage of the flood claim. Therefore, the larger the flood claim, the larger the payment to the private insurance company. What is in question is whether FEMA has the ability to monitor the conflict and exercise appropriate controls to ensure that it is not abused.

b. What additional steps would you suggest to mitigate this conflict?

There are a number of steps that could be taken to mitigate this conflict. First, FEMA could strengthen its oversight of the WYO program. For example, it could strengthen the quality reinspection process to ensure that losses are adjusted accurately including documenting the oversight provided by the reinspection. Second, it could systematically collect information needed to determine when a single private insurance company is responsible for adjusting its own claim as well as a flood claim on the same property. Perhaps in these situations, FEMA could adopt addition internal control steps to ensure that the flood claim is accurately adjusted. For example, the quality adjuster would have to perform additional quality assurance testing to ensure that the damages were verified and property adjusted.

3. Do you believe FEMA is sufficiently attuned to the potential for abuse when private insurance companies both hold a wind policy and adjust a government-underwritten flood policy?

    a. Is FEMA taking adequate steps to ensure that any conflict of interest is avoided?

    It is not clear that FEMA has taken steps to address this inherent conflict of interest or to mitigate the appearance of a conflict of interest through heightened internal control procedures. Our report on this issue is scheduled to be issued later in 2007.

4. When auditing NFIP claims, FEMA claims it does not take into account whether there was wind damage or payment under a wind policy. In fact, the NFIP collects no data on wind payments, as they are only concerned with whether there was a basis for a flood payment.

    a. Do you believe FEMA can adequately audit an NFIP claim without looking at data concerning the wind side of the adjustment?

    While focusing on the basis for the flood claim may be sufficient for some claims, there are situations where it may be necessary for FEMA to have access the wind claim damages as well. For example, if the property had been compromised or proof of loss statements were heavily relied upon, then comparing information in the wind claim file may be useful in verifying the accuracy of a claim.

    b. If not, what information do you believe FEMA and the NFIP need to collect in order to properly audit a flood claim?

    From an oversight and internal control perspective, we believe it would be useful for FEMA to collect, at a minimum, whether the Write-Your-Own (WYO) insurance company is also the property-casualty insurance company on the property. Other information would include whether it was a multi-peril event, and in certain instances, what the damage claims were associated with the other peril(s) such as wind in the case of hurricanes.

5. Does the NFIP have sufficient staff, both to do its job and to perform oversight of the WYO companies?

    a. To what extent does the NFIP rely on contractors for managing the program and for oversight?

    In our September 2007 report(GAO-07-1078) entitled, we reported that FEMA had about 68 employees and 170 contractors manage and oversee the NFIP and the National Insurance Fund FEMA and its program contractor are responsible

for monitoring and overseeing the quality of the performance of the Write-Your-Own insurance companies to assure the NFIP is administered properly.

b. Do you believe that there is an over-reliance on contractors?

We have not looked specifically at this issue but believe both their reliance on, and oversight of, contractors warrants additional scrutiny.

c. Does the NFIP take steps to ensure that these contractors do not perform inherently governmental functions?

We have an ongoing engagement in which we plan to review FEMA's internal controls over its largest contracts. This is one of the areas that we plan to include in our work.

6. I understand that FEMA has said it is concerned that if it requires the WYO companies to provide more information on the adjudication of wind claims, they will pull out of program entirely.

a. How much money do the WYO companies make off each flood claim, and do they bear any risk?

In addition to earning about 30 percent for selling flood policies, WYO insurance companies use an adjuster fee schedule for adjusting claims which sets their payment as either a dollar amount or a percentage of the loss. The fees for claims adjustment range from $60 to $1,250 in flat fees for losses up to $50,000. For claims above $50,000, the fees range from 2.1 percent to 3 percent depending on the size of the claim. Moreover, for claims processing the WYO insurers receive an additional 3.3 percent of the actual paid loss.

These companies bear no portion of the risk for the policies they sell and service.

b. Do you believe FEMA's concern - that WYO companies would withdraw from the program if they were required to submit more claims information - is valid?

We have questions about the basis of this concern. However, we recognize that participation in the program is voluntary and private insurance can opt not to participate if the costs to administer the program outweigh the benefits.

COMMITTEE ON FINANCIAL SERVICES
Subcommittee on Oversight and Investigations
and
COMMITTEE ON HOMELAND SECURITY
Subcommittee on Management, Investigations, and Oversight

Joint Hearing on "National Flood Insurance Program: Issues Exposed by the 2005 Hurricanes"
June 12, 2007

QUESTIONS BY RANKING MEMBER MIKE ROGERS

For Both Witnesses

The head of the Alabama Department of Insurance, Commissioner Walter Bell, has stated his Department learned a lot of lessons from Hurricane Ivan in 2004. Therefore, after Hurricane Katrina hit, he set up operations at each of the FEMA disaster recovery centers, and Department representatives visited shelters throughout the state.

- Have you seen examples where other states have incorporated "lessons learned" from past hurricanes?

  We have some examples of "lessons learned" during the course of our ongoing review. For example, prior to Hurricane Katrina, the State of Florida developed a web-based system to monitor and track hurricane-related claims being processed by property-casualty insurers. In the aftermath of Hurricane Katrina, several coastal states recognized the need to monitor the claims processing activities of property-casualty insurers more closely and opted to utilize this data call mechanism, aided with technical assistance provided by the National Association of Insurance Commissioners (NAIC). The states, through NAIC, are currently developing specifications for an enhanced system to monitor claims resulting from various types of catastrophes. Additionally, since Hurricane Katrina, some states have initiated legislation to improve the licensing and training requirements for claims adjusters that operate in their state.

- What are some of the "lessons learned" from the 2005 hurricanes that states should incorporate to be better prepared for the next major hurricane or other catastrophe?

  We currently have work underway looking at "lessons learned" from the 2005 hurricanes and what changes need to be made to help ensure a more timely and effective rebuilding effort in the future. See GAO-07-1079T

Another initiative launched by Alabama's Insurance Commissioner Bell was a mediation program for storm-related claims following Hurricane Katrina. Under this program operated by the state's Department of Insurance, companies that had outstanding claims in Alabama sent notices that a mediation program was available. According to an October 2006 news article in the *Insurance Journal,* Alabama's mediation program had a 90 percent success rate.

- Are you aware of any other states that have a similar mediation program?

  Florida created a mediation program after Hurricane Andrew in 1992. According to the National Association of Insurance Commissioners, Florida's innovative 2004 mediation program became the model for programs in Alabama, Mississippi, and Louisiana.

  Our work on this issue focused on Gulf Coast states and there are likely other states that have similar programs (e.g., North Carolina) This list is, therefore, not exhaustive.

- In your view, what are some of the benefits of a mediation program?

  Mediation can offer several benefits. For example, it can help prevent burdening the court systems with law suits. It can also offer homeowners an option to resolve a dispute without the costs associated with a lengthy legal dispute. Moreover, it can offer policyholders and insurers a more timely alternative to resolve differences. Because the mediation is nonbinding, those who are not satisfied with the process—either policyholders or insurers—retain their right to go to court. Finally, it can help reduce the number of unresolved claims.

- The mediation program in Alabama was focused on storm-related claims. What are your views of using mediation for other types of claims?

  Based on our work, we have no position on mediation for other types of claims at this time.

- Given the success rate of the mediation program in Alabama, what steps would you suggest to encouraging other states to adopt a similar program?

  Work with the National Association of Insurance Commissioners to explore this issue further.

According to data compiled by FEMA, the 2005 hurricane season was the costliest storm season on record. The National Flood Insurance Program paid flood insurance policy holders more than $15 billion to recover from storm damage, including more than $250 million for policy holders in Alabama.

- What are your views regarding the current operations of the National Flood Insurance Program?

We placed the NFIP on GAO's list of high-risk programs in March 2006. While we have reported on the program for over three decades, the 2005 hurricane season highlighted the precarious financial stability of the program and need for fundamental reform. Our work highlights the four challenges facing the NFIP. First, its is by design not actuarially sound, in part, because of subsidized properties that were built before Flood Insurance Rate Maps (Pre-FIRM) were created in their community. Some of these properties are also subject to repeated losses, which place a drain on the program. Second, FEMA faces ongoing challenges ensuring and encouraging broad participation in the program, which is needed to better enable the NFIP to spread its risks and pay for losses out of premiums. Third, FEMA's efforts to update maps that in most cases where created more than a decade ago continues to be a challenge. Hurricane Katrina revealed the need to revamp FEMA's map modernization efforts and the need to periodically update maps to ensure they reflect both the best science as well as changes in development in order to show current flood risks. Finally, FEMA's ability to oversee the program faces ongoing challenges including its oversight of the Write-Your-Own insurance companies and contractors.

- Do you believe more homeowners should be involved in this program? If so, how would you suggest they be encouraged to obtain coverage?

  As we reported in an August 2007 report (GAO-07-403) entitled "Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework," flooding is the most widespread and destructive hazard in the United States and all states are likely to experience some degree of flooding. Because flooding is so widespread, it presents risks to a large segment of the population. For example, from 1980 through 2005, 97 percent of the U.S. population lived in a county that experienced at least one declared flood disaster and about 45 percent lived in counties that had experienced six or more. Yet, according to the 2006 Study commissioned by FEMA, the market penetration outside of special hazard risk areas, for homeowners was only 1 percent.

  We believe that FEMA's "FloodSmart" media campaign is an important first step in educating communities about the risks of flood. Insurance companies and lenders also have important roles to play. Likewise, state and local comities also have a role. For example, in 2006 California considered legislation that would have mandated everyone to buy flood insurance in designated portions of the state. However, given that most people do not view themselves as at risk for flood losses, participation in the program will likely continue to be a challenge as purchase of flood insurance for some homes in Special Flood Hazard Areas, and for all homes outside is voluntary.

- Do you believe the current rates for flood insurance coverage are reasonable?

  Given that NFIP rates vary depending on flood zone, whether the property is FIRM or Pre-FIRM, type of coverage (structure versus contents),and amount of protection

purchased, there is no simple answer. We will be a in a better position to answer the question once we complete our ongoing work looking on the nonsubsidized rates and their actuarial soundness. However, as with any catastrophic insurance program, those most at risk should expect to pay the highest rates.

On average premium amounts vary according to the amount of coverage purchased and the location and characteristics of the property to be insured, the average yearly premium for a 1-year policy was $475 as of February 2007. See GAO-07-1078.

- In your work, have you seen any special factors that folks in Alabama should be aware of? If so, what steps should these folks take to be sufficiently prepared?

  While the factors are not exclusive to folks in Alabama, in general folks should be aware of the implications of not having adequate insurance and understanding the terms and limitations of their policies. For example, determining whether it makes sense to have flood insurance whether they are required to have it or not. A decision not to purchase when required to can have implications for their ability to obtain financial assistance from other federal agencies such as the Small Business Administration. Also if a property has a high risk of flooding and is valued at more that the $250,000 in coverage available from the NFIP, the owner may want to explore excess coverage above the NFIP maximum which is available in the private insurance market. Also it is important for renters to know that they can obtain contents covers to protect their possessions in the event of a flood.

High-risk areas in the country are referred to as Special Flood Hazard Areas.

- Could you please explain what special requirements apply to homeowners in one of these high-risk areas?

  The purchase of flood insurance is mandatory if the homeowner has a federal or federally-backed financial assistance for the acquisition and/or construction of buildings in these areas. That is, if a homeowner has a mortgage with a lender regulated by the federal government or sold in the secondary market, they must but flood insurance. The amount of flood insurance coverage required by the Flood Disaster Protection Act of 1973, as amended by the National Flood Insurance Reform Act of 1994, is the lesser of the following: (1) The maximum amount of NFIP coverage available for the particular property type; (2) The outstanding principal balance of the loan; or (3) The insurable value of the structure.

- Do you believe the Federal Government has accurately identified all high-risk areas, or would you suggest additional designations of Special Flood Hazard Areas?

  Given that FEMA in the process of updating and digitizing its flood maps, it's likely that some special hazard areas have yet to be designated as such.

To what extent does the National Flood Insurance Program coordinate its oversight and settlement procedures with state insurance regulators? What more can NFIP do in this area?

While this was not a major focus of our work, we found little obvious evidence of coordination of oversight and settlement procedures with the state regulators. FEMA told us that they consider the state insurance regulator's market conduct examines as one of the oversight mechanisms to ensure that the Write-Your-Own insurance companies are functioning appropriately. We found that FEMA does not participate in any state mediation programs. While we understand the legal reasons for not doing so, this is an area that warrants debate and consideration. FEMA may want to explore other ways to leverage the state regulators to bolster there oversight of the Write-Your-Own insurance companies including exploring whether the states have access to data that may be beneficial to FEMA's evaluation of its flood claims data.

Do you believe NFIP obtains adequate information and performs meaningful oversight in the claims adjustment process? If not, what steps should NFIP take to improve its work in this area?

We have questions about the information that FEMA collects during the claims adjustment process and during the quality reinspection process. We also have questions about its oversight of this process. In our previous work on FEMA's claims process (GAO-05-119 & GAO-07-169), we found that FEMA did not pull a random sample of files to review, which precluded them from being able to project their findings to the universe of claims. It appears that FEMA relies heavily on the oversight that WYO insurers provide for their adjusters. In fact, for Katrina claims, we found FEMA did not analyze the results of its quality reinspection process, which would have enabled them to identify trends in claims or possible issues that warranted further review. In our ongoing work involving the Write-Your-Own (WYO) program, we plan to further explore FEMA's oversight of the claims adjustment process including the sufficiency of its internal controls. In response to our recommendations, FEMA plans to pull a random sample of claims for quality reinspections in the further and analyze the results of the review.

What are the options under NFIP for residents living in high risk flood zones who have been dropped by their insurance companies?

For flood insurance, options include contacting an independent insurance agent. The NFIP website also has a list of all participating insurance companies. If the property-casualty insurance coverage is dropped, residents should also contact an independent agent. Other options would be to contact the state insurance commissioner or for certain perils (e.g., wind) there may be a state-run fund or pool available. Alternatively, the homeowners could contact the NFIP itself. About four percent of NFIP's flood policies are sold and managed directly by the NFIP.

Do you believe NFIP adequately considers whether wind losses that precede flood losses should be deducted from the federal share of coverage? If not, what steps should NFIP take to improve its work in this area?

As a matter of course FEMA does not consider wind damage that may precede flood losses. According to FEMA, if there was a flood event, they would be obligated to pay for items

damaged by flooding even if they were also damaged by wind. Although we did find that NFIP performed some preplanning with some state-sponsored wind insurers pertaining to how adjusters would be assigned and perform their duties for properties involving both wind and flood damages through the Single Adjuster Program. Such practices have only been used in a small number of claims.

Based on your work, does any regulator in the system have the combined information for properties damaged by both wind and flooding that would be necessary to determine whether the apportionment of losses is appropriate? If not, what is your recommendation to ensure that this information is collected in a reliable way?

We found that no regulator generally has the combined information.

Do you believe NFIP expends sufficient resources on claims review and oversight? If not, what problems occur due to insufficient oversight?

As we reported in October 2005 (GAO-06-119), the program contractor responsible for conducting quality reinspections had nine general adjusters responsible for performing quality reinspections. In December 2006 (GAO-07-169) we reported that according to the general adjuster in charge, four general adjusters were on board following Hurricanes Katrina and Rita. To supplement the number of general adjusters, FEMA's program contractor hired 22 temporary employees. According to FEMA officials, FEMA formed a taskforce of 15 adjusters and supervisors to review and reinspect additional claims closed using expedited methods. We did not evaluate whether this level of resources was sufficient. As reported in December 2006, FEMA conducted 4,316 reinspections on approximately 171,000 NFIP claims for Hurricanes Katrina and Rita.

If the claims oversight process is not sufficient, this could result in improper claims adjustment going undetected, which could potentially harm policyholders and/or the program, depending on whether the claim was under- or overpaid. Given the importance of this process to the internal controls of the WYO program, if this process lacks sufficiency and rigor, it can raise questions about the FEMA's oversight of the WYO program.

To what extent does NFIP rely on private industry for claims adjustment? What steps currently are, or are not, being taken to avoid conflicts of interest?

Private insurance companies sell and service 96 percent of NFIP policies through the WYO program. These companies are responsible for adjusting the claims of policies they sell. As mentioned in the question, FEMA has a program contractor who performs quality reinspections on a sample of these claims. Moreover, FEMA conducts periodic operational reviews of the WYOs and each WYO insurance company is also to have a biennial financial audit. FEMA can also conduct audits for cause and state insurance department audits.

We have started an engagement that will include a review of FEMA's oversight of the WYO program and we plan to explore what internal control measures are aimed at mitigation the potential for conflicts of interest inherent in the program. We plan to report out in 2008.

Recent news articles claim that insurers have over-billed rebuilding costs associated with flood coverage, thereby inflating the portion of a consumer's losses that are reimbursed by the Federal Government.

- Based on your review, have you encountered this problem? If so, what are some of the implications that arise for NFTP? What steps would you recommend be taken to address this problem?

  While our review included reviewing hundreds of claims files, our focus was on whether the adjusters collected and considered wind damage information when adjusting hurricane-related flood claims. However, it is our understanding that this is an issue that the DHS Inspector General plans to evaluate as part of its work on this issue.

According to a June 10 editorial in the New Orleans *Times-Picayune,* it is – quote – "surprisingly easy" -- close quote --for insurers to – quote -- "pump up the charges of the government and underestimate their own liability."

What measures have been implemented or could be implemented to monitor this to ensure that it does not happen?

The quality reinspection program, if functioning properly, would be the best opportunity way monitor whether adjusters are properly adjusting claims and that claims reflect the material cost guidelines issued by NFIP. Also FEMA can conduct a for cause audit at the WYO if it has reason to question the claims handling process. For example, losses being paid when not covered or consistent overpayment of claims by the WYO. However, in our 2007 report we found that FEMA had not conducted any audits for cause during the 7-year period of our review ending fiscal year 2006. Moreover, without access to the wind claims files, it is difficult for FEMA to (1) determine if a problem may exist, or (2) assess the extent of a problem.

According to a June 10 editorial in the New Orleans *Times-Picayune,* the improper costs to the flood program could total more than $9 billion.

- Could you elaborate on why this problem has been overlooked for some time?

  We have seen the editorial but have no insights to offer.

The Financial Services Roundtable Report on Mega-catastrophes recommended (page 9) several measures to improve the National Flood Insurance Program, including putting the program on sound actuarial basis and upgrading flood maps.

- Based on your experience, what are your views regarding these recommendations?

These recommendations attempt to address the greatest challenges facing the NFIP. They are consistent with the type of issues we raised in putting NFIP on GAO's high-risk list in March 2006. They are all issues that should be considered as part of the discussion involving NFIP's reauthorization. However, as with any policy issue, the ultimate solution will involve trade-off that will have to be carefully considered.

- Are you familiar with this report? If so, do you know what progress has been made toward the implementation of these recommendations?

  We are familiar with the report and FEMA has efforts underway that are responsive to the recommendations. For example, NFIP's FloodSmart marketing campaign is intended to educate all consumers about the risks of flooding and the benefits of protecting their homes and businesses with flood insurance. To increase the financial stability of the program, various bills introduced in Congress have addressed some of the other issues raised in the report including phasing out subsidies for second homes and nonresidential properties, expanding mandatory purchase requirements, and raising insurance ceilings. FEMA has a $1 billion Flood Map Modernization effort underway. Following a mid-course adjustment and in response to input from Congress, GAO and others, FEMA says it has implemented changes to this program that will result in better-targeted and more accurate flood data. FEMA is also using sequencing to compare flood risks between communities and to prioritize mapping for the higher-risk area.

- What kinds of resources would be needed to implement such recommendations? What types of oversight would you recommend?

  Focusing on map modernization and expanding participation, FEMA would need to continue make both issues an ongoing priority and focus. Both efforts tend to be resource intensive. While map modernization is import, keeping the maps current must be an ongoing focus of FEMA's efforts. Likewise, educating consumers about the risks of flooding and the benefits of the program is likely to be an ongoing challenge. Oversight including performance and accountability measures will also need to monitored and evaluated on an ongoing basis.

For Deputy Inspector General Matt Jadacki

Should the National Flood Insurance Program have access to Write-Your-Own insurance companies' home owner's claim data to ensure that the claims for both flood and wind on the same structure were fair and equitable?

How do you rate the National Flood Insurance Program oversight on the Write-Your-Own insurance companies? Does it need to be increased?

Does the National Flood Insurance Program's re-inspection process take into account damage from wind? If it is determined that the Program paid for damages other than flood, how are the funds returned to the program?

The National Flood Insurance Program collects nearly $2 billion per year and pays out several billion in claims through the Write-Your-Own insurance companies. Given that so much federal funds are in the hands of private insurance companies, do you believe that financial oversight is adequate?

For GAO Director Orice Williams

Based on your testimony on page 3, the National Flood Insurance Program has inadequate, unsystematic data collection for property damage assessments.

- Is this due to lack of resources? Lack of an adequate collection process? Or, both?

  We did not specifically look at the issue of resources we did identify some issues with the adequacy of the data collection process. Specifically, we found that the reinspection process lacked the data needed to evaluate the extent that properties had combination losses and whether such losses would have any impact on the flood claims paid by NFIP.

On page 10 of your testimony, you say that the National Flood Insurance Program does not collect the necessary information to help evaluate whether it has paid only what it is obligated to pay under the flood policy for properties subjected to both wind and flood damage.

- Could you elaborate on the types of data that are necessary to be collected to evaluate flood and wind damages?

  In certain instances where there is combined wind and flood damage, FEMA may benefit from being able to access wind claim information when paying a flood claim. According to FEMA for most properties, it would be able to determine the accuracy of a flood claim without looking at the wind claim or damages. While FEMA maintains that it can determine the accuracy of a flood claim by analyzing the flood claim, there are instances where additional information could be useful, including cases where a WYO insurer may have a conflict of interest if they determine flood damages, paid by NFIP, and wind damages, paid by itself, and determining the cause of damage is challenging or open to dispute.

What types of data did the Write-Your-Own insurance companies and National Flood Insurance Program collect and how can that collection be improved?

Through the Transaction Record Reporting and Processing (TRRP) Plan, WYO insurers are required to submit flood damage claims information to NFIP. For example, *information collected through the TRRP Plan for flood claims includes data fields that describe, among other*

things, the: Property Street Address, Date of Loss, Cause of Loss, Total Building Damages, Total Damages to Contents, Total Amount of Insurance – Building, Total Amount of Insurance – Contents, Building Claim Payment, and Contents Claim Payment. However, we found that NFIP does not require WYO insurers to report information on property damages in a manner that allows NFIP to identify when damages might have multiple causes or to differentiate how these damages (to the building or its contents) were divided between flooding and other causes, even when the WYO insurer is also the wind insurer for the property

One of the problems identified by the Government Accountability Office that is facing the National Flood Insurance Program (NFIP) is how seriously under-funded the program is. Currently, the program is borrowing several billion dollars to cover losses from Hurricane Katrina that are estimated to be around $25 billion.

- Could you please discuss this problem in greater detail and its future implications for the taxpayers?

  While we have not looked at this issue specifically, according to FEMA, it paid about $15.7 billion in claims following the 2005 floods as of January 2007. The claims for Hurricanes Katrina, Rita, and Wilma far surpass the total claims paid in the 38-year history of the NFIP. As of August 2007, the cumulative debt owed by the NFIP was about $17.5 billion with estimated annual interest payments of approximately $1 billion. Given the current structure of the NFIP, it is unlikely to be able to generate sufficient revenues from premiums to repay the billions borrowed from the Department of the Treasury. Moreover, it is unlikely that NFIP—a key component of the federal government's efforts to minimize the damage and financial impact of floods—could cover catastrophic losses in future years. If a catastrophic flood were to occur, the NFIP would have to borrow additional funds from Treasury.

CHAIRMAN MELVIN L. WATT
SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS
FINANCIAL SERVICES COMMITTEE

HEARING ENTITLED "NATIONAL FLOOD INSURANCE PROGRAM: ISSUES EXPOSED BY THE 2005 HURRICANES"

Tuesday, June 12, 2007

QUESTIONS FOR THE RECORD

The Subcommittee appreciates your testimony in the above-entitled hearing. Below, please find follow up questions to which we request additional answers for the record. The Subcommittee would appreciate your written response on or before July 12.

Ms. Orice Williams, Director, Financial Markets and Community Investment, Government Accountability Office

(1) Has your investigation revealed that insurers shifted the burden of proof to policy-holders to prove wind claims instead of placing the burden upon insurance companies to prove that wind is excluded before they deny coverage?

Our review has not touched on this issue, which is the subject of ongoing litigation.

(2) What additional data should the NFIP collect from WYO companies?

From an oversight and internal control perspective, we believe it would be useful for FEMA to collect, at a minimum, whether the Write-Your-Own (WYO) insurance company is also the property-casualty insurance company on the property. Other information would include whether it was a multi-peril event, and in certain instances, what the damage claims were associated with the other peril(s) such as wind in the case of hurricanes. However, according to FEMA, the NFIP currently does not have access to this information.

(3) Does the NFIP collect enough data to know when the same insurance company is the WYO flood insurer and the wind insurer? If not, how can the NFIP monitor the proper apportionment of wind vs. flood damage?

The NFIP does not collect enough information determination when a single insurance company is the WYO flood insurer and the wind insurer. Therefore, it cannot monitor how claims are apportioned.

(4) Do you see an inherent conflict of interest when a single WYO company adjusts both the WYO flood claim and the private insurance homeowner's policy?

There is an inherent conflict of interest when a single WYO insurance company adjusts both the wind policy and flood policy.

(5) The NFIP instituted a special "expedited" claims process after hurricanes Katrina and Rita? Do you see any problems with this expedited process? After the claims were processed on an expedited basis, did the NFIP go back and collect wind damage data to determine the proper allocation of wind vs. flood damage? Should it have done so?

As we reported in our December 2006 report (GAO-07-169), about 11 percent of the Hurricane Katrina claims were adjusted using expedited procedures. FEMA authorized payments of $750 per expedited claims adjustment (lower that the fee that would have been paid for the standard adjustment process). Two large WYO insurance companies

developed models that were approved by FEMA for use in one of the expedited approaches. However, we found that because the use of the approved models was not tracked carefully during Hurricanes Katrina and Rita, FEMA paid these companies its higher standard fee for expedited claims adjustments.

FEMA's program contractor completed quality reports for just over 10 percent of the expedited claims. The quality assurance reinspections are a standard oversight procedure after all flood events. However, FEMA formed a special task force of 15 adjusters to review and reinspect additional claims closed using expedited methods to obtain additional information about the accuracy of payments made. According to FEMA, the special task force found erroneous payments in about 5 percent of the claims.

The quality reinspections do not systematically collect information about wind damage or how damages were apportioned. In certain situations, such additional information may have been useful. For example, in some situations the flood claims data alone may not have sufficiently answered questions about how the flood loss was adjusted.

(6) The GAO's preliminary review found that aggregate data collected by States would be of limited value to the NFIP because the information was not in sufficient geographic detail to allow a meaningful evaluation of flood vs. wind damage. What is the appropriate level of geographical detail for such a State insurance database?

Currently, such issues are being debated by state insurance regulators and industry participants, through National Association of Insurance Commissioners, as they continue to develop and refine specification for a new claims reporting mechanism to be utilized in the event of a catastrophe.