



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

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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

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.

NATIONAL FLOOD INSURANCE PROGRAM

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

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

¹NFIP 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

²NFIP 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

³Claims 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

⁴NFIP 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.

⁵GAO, *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.

⁶Approximately 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

⁷GAO, *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

⁸In 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

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