

GAO

Report to the Ranking Member,
Committee on Financial Services,
House of Representatives

December 2007

NATIONAL FLOOD INSURANCE PROGRAM

Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed





Highlights of [GAO-08-28](#), a report to Ranking Member, Committee on Financial Services, House of Representatives

Why GAO Did This Study

Disputes between policyholders and insurers after the 2005 hurricane season highlight the challenges in understanding the cause and extent of damages when properties are subjected to both high winds and flooding. Questions remain over the adequacy of steps taken by the Federal Emergency Management Agency (FEMA) to ensure that claims paid by the National Flood Insurance Program (NFIP) cover only those damages caused by flooding. GAO was asked to evaluate (1) issues that arise when multiple insurance policies provide coverage for losses from a single event, (2) state regulators' oversight of loss adjusters, and (3) information that NFIP collects to assess the accuracy of damage determinations and payments. GAO collected data from FEMA, reviewed reinspection reports and relevant policies and procedures, and interviewed state regulatory officials and others about adjuster oversight and NFIP.

What GAO Recommends

GAO recommends granting FEMA authority to obtain available WYO insurer wind damage claims data for properties subjected to both high winds and flooding and WYO insurers' guidance to adjusters for making such damage determinations. Further, GAO recommends that states enhance the quality and consistency of adjuster oversight. FEMA agreed with GAO's recommendation to enhance adjuster oversight but did not agree that Congress should grant it enhanced authority to access WYO insurers' wind claims data and adjuster guidance.

To view the full product, including the scope and methodology, click on [GAO-08-28](#). For more information, contact Orice M. Williams at (202) 512-8678 or williamso@gao.gov.

NATIONAL FLOOD INSURANCE PROGRAM

Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed

What GAO Found

Insurance coverage gaps and claims uncertainties can arise when coverage for hurricane damage is divided among multiple insurance policies. Coverage for hurricanes generally requires more than one policy because private homeowners policies generally exclude flood damage. But the extent of coverage under each policy depends on the cause of the damages, as determined through the claims adjustment process and the policy terms that cover a particular type of damage. This process is further complicated when the damaged property is subjected to a combination of high winds and flooding and evidence at the damage scene is limited. Other claims concerns can arise on such properties when the same insurer serves as both NFIP's write-your-own (WYO) insurer and the property-casualty (wind) insurer. In such cases, the same company is responsible for determining damages and losses to itself and to NFIP, creating an inherent conflict of interest.

Differences in licensing and training requirements for insurance claims adjusters among states also create uncertainties about adjusters' qualifications. Prior to the 2005 hurricane season, some coastal states had few or no requirements, while others had requirements for most types of adjusters. Further, states can waive their normal oversight requirements after a catastrophic event to help address demand, as they did after Hurricane Katrina. As a result, significant variations can exist in the qualifications of claims adjusters available after a catastrophic event. Strengthened and more uniform state requirements for adjusters could enhance the qualifications of the adjuster force in future catastrophes and improve the quality and consistency of claims adjustments.

NFIP does not systematically collect and analyze both wind and flood damage claims data, limiting FEMA's ability to assess the accuracy of flood payments on hurricane-damaged properties. The claims data collected by NFIP through the WYO insurers—including those that sell and service both wind and flood policies on a property—do not include information on whether wind contributed to total damages or the extent of wind damage as determined by the WYO insurer. The lack of this data also limits the usefulness of FEMA's quality assurance reinspection program to reevaluate the accuracy of payments. In addition, the aggregate claims data that state insurance regulators collectively gathered after Hurricanes Katrina and Rita were not intended to be used to assess wind and flood damage claims together on a property- or community-level basis. Further, FEMA program contractors do not have access to WYO insurers' policies, procedures, and instructions that describe to adjusters how wind and flood damages are to be determined when properties are subjected to both perils. FEMA officials stated that they did not have the authority to collect wind damage claims data from insurers. But without the ability to examine claims adjustment information for both the wind and flood damages, NFIP cannot always determine the extent to which each peril contributed to total property damages and the accuracy of the claims paid for losses caused by flooding.

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Abbreviations

FEMA	Federal Emergency Management Agency
NAIC	National Association of Insurance Commissioners
NFIP	National Flood Insurance Program
TRRP	Transaction Record Reporting and Processing
WYO	write-your-own

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United States Government Accountability Office
Washington, DC 20548

December 28, 2007

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

Dear Mr. Bachus:

Hurricanes pose unique challenges for insurers and property owners because damages caused by these storms can result from multiple perils. Among these are high winds and flooding, the combination of which caused unprecedented damage during Hurricane Katrina. After such an event, a necessary and challenging task is determining the extent of the damage caused by each peril, as wind and flood damages are generally covered under different types of insurance policies. Private property-casualty insurance policies generally exclude flood damage, which is covered by federally backed flood insurance under the National Flood Insurance Program (NFIP). Since 1968, the federal government has offered flood insurance policies through NFIP, a program now administered by the Federal Emergency Management Agency (FEMA), U.S. Department of Homeland Security.¹ However, private property-casualty insurers may sell both types of policies—their own property-casualty insurance and flood insurance on behalf of NFIP—and thus be responsible for determining whether property damages were caused by wind or flooding after hurricanes. Since the devastating 2005 hurricane season, questions have been raised about how damage determinations are made, the oversight of such activities, and the accuracy of the resulting claims payments.

The unprecedented scope of the damage from Hurricane Katrina created special challenges for insurers and their insurance claims adjusters, who were responsible for determining the cause and extent of damages. The scope of the damages meant that many more adjusters were needed than were available, creating delays in the adjustment process. At the same time, adjusters had difficulty reaching properties because of the extent of the devastation. Evidence at the damage scenes was often limited or

¹The NFIP was established under the authority of the National Flood Insurance Act of 1968, 42 U.S.C. §§ 4001 et seq., as a subsidized program sponsored by the federal government.

compromised, making assessments and apportionments of damages more difficult. These challenges further contributed to the concerns, controversies, and disputes over the damage determinations made by insurance adjusters.

In response to these issues and other concerns, you asked us to evaluate (1) the issues that can arise for homeowners when multiple insurance policies provide coverage for losses from a single event, (2) state insurance regulators' oversight of the licensing and performance of loss adjusters, and (3) the information that NFIP collects and analyzes in order to determine whether damage determinations and flood claims payments accurately reflect the actual distribution of losses between wind and flooding.

To accomplish our work, we discussed information and issues associated with insurance coverage and claims processing activities with FEMA, NFIP program contractors, state insurance regulators, the National Association of Insurance Commissioners (NAIC), property-casualty insurers, state-sponsored wind insurers, insurance agents, claims adjusters, industry associations, and mediators. We also obtained licensing and training requirements for claims adjusters from state insurance regulators and industry representatives. Further, we 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 (740) of reinspections that NFIP conducted for selected properties. Appendix I provides additional information concerning the scope and methodology of our work. We conducted our work between May 2006 and November 2007 in Florida, Illinois, Louisiana, Mississippi, North Carolina, Pennsylvania, South Carolina, and Texas in accordance with generally accepted government auditing standards.

Results in Brief

With coverage divided among multiple insurance policies, potential gaps in coverage and difficulties in settling claims can arise from hurricane events. Insurance coverage for hurricane damage generally requires the purchase of multiple insurance policies because property-casualty policies for buildings and their contents generally exclude coverage for damage caused by flooding. However, the limits and extent of coverage offered by NFIP's flood insurance policies differ from those of private property-casualty policies. For example, a property owner cannot purchase flood insurance coverage through NFIP for building damages over \$250,000 or for additional living expenses. Such coverage for other types of damages—

for instance, those caused by wind—may be available under a homeowners policy. Therefore, prior to a hurricane event, a property owner cannot be certain of the damages or the expenses that will be covered because the extent of coverage depends on the cause of the damages, as determined during the claims adjustment process, and how the damages will be covered by the various policies. As a result, homeowners whose properties incur what is determined to be flood rather than wind damage may find themselves without the funds they need to repair or replace their homes if they lack sufficient flood insurance. The claims adjustment process can become more difficult when the damaged or destroyed property is subjected to a combination of high winds and flooding. Finally, an inherent conflict of interest exists when the same insurance company is responsible for determining the extent of the flood damage that NFIP must pay and the extent of the wind damage that is the responsibility of the company itself. Disputes between property-casualty insurers and policyholders continue over the damage determinations made after Hurricane Katrina and the interpretation of policy language concerning coverage on properties subjected to a combination of high winds and flooding.

Although the role of insurance claims adjusters is crucial after a major catastrophe, licensing and training requirements for adjusters vary considerably among states, creating uncertainties about adjusters' qualifications. Some states have no requirements for insurance claims adjusters, while others have licensing and training requirements for most types of adjusters operating in the state. Many states have licensing and training requirements for some types of adjusters, but not for other claims adjusters that may also be called upon after a catastrophe. Further, licensing and training requirements may be temporarily relaxed after a catastrophe, meaning that adjusters entering a state may not have met the normal requirements needed to work there. As a result, the qualifications and training of adjusters who assess damages following a catastrophic event may vary significantly. State insurance regulators told us that they generally relied on the insurance companies to ensure the quality of their adjusters and adjustment processes, though states may also choose to conduct reviews of claims already processed through market conduct examinations.² In order to adjust flood insurance claims, adjusters are to

²State insurance regulators periodically perform market conduct examinations on insurance companies to review their market practices, including sales, underwriting, and claims processing and payment activities.

be trained and certified by NFIP, in addition to the state requirements. Following Hurricane Katrina, some states that lacked licensing requirements for adjusters passed laws to raise the level of oversight for adjusters. Several states affected by recent hurricanes have also initiated market conduct examinations to evaluate insurers' claims adjustment processes, in part because of consumer complaints about the handling of hurricane-related claims.

We found that the claims information NFIP collects may not always allow FEMA to effectively oversee damage determinations and apportionments after hurricane events in order to ensure the accuracy of NFIP claims. NFIP, the repository for flood claims information, has collected and analyzed data on flood insurance claims submitted by insurance companies that service NFIP policies. However, the data do not include information on total damages caused by all perils, including wind, which could be useful in some cases. Rather, the data are focused on the damage deemed to have been caused by flooding, even when the write-your-own (WYO) insurer making the flood damage determination is also the wind insurer on the same property. This lack of data also adversely affects the ability of FEMA's reinspection program to assess the accuracy of certain NFIP claims adjustments and payments.³ FEMA officials and NFIP program contractors state that they do not have the authority to access data or information from WYO insurers on wind claims associated with properties for which a flood claim has been received or the policies, procedures, or instructions developed by the WYO insurer that instruct adjusters how to discern wind versus flood damage when properties may have been subjected to both perils.⁴ Consequently, for a given property, FEMA's ability to assess the accuracy of payments for damage caused only by flooding is limited because NFIP does not know what portion of the total damages was caused by wind and what portion was caused by

³Through its program contractor, FEMA operates a reinspection program to monitor and oversee claims adjustments and address concerns about flood payments by reevaluating a sample of flood claims.

⁴FEMA states that it has statutory authority to obtain certain additional claims data but that its access is limited to the purposes of audit and examination and not for initial claims processing. Specifically, the National Flood Insurance Act gives FEMA access, for the purpose of audit and examination, to any books, documents, papers, and records of the WYO companies that are "pertinent to the costs of the program undertaken or the services being rendered." 42 U.S.C. § 4084. The Act requires WYO companies to keep such records as FEMA prescribes, including "records which fully disclose the total costs of the program undertaken or the services being rendered, and such other records as will facilitate an effective audit." *Id.*

flooding. Without the ability to obtain this information in a systematic fashion for certain properties, FEMA is limited in its ability to monitor or reevaluate the accuracy of payments made for hurricane-damaged properties that are severely damaged and subjected to a combination of high winds and flooding. Following the 2005 hurricane season, state insurance regulators collected, analyzed, and aggregated data on hurricane damage claims for wind-related losses reported by property-casualty insurers. We attempted to use this information to supplement FEMA's data, but because it was collected to monitor the claims processing activities of insurers related to the timeliness of claims payments and their impact on insurer solvency, and was not intended to assess wind versus flood damage determinations, it did not provide sufficient geographic detail to match with corresponding flood claims data for a particular community or property.

This report includes two matters for congressional consideration aimed at improving FEMA's oversight of flood claims when properties are subjected to both high winds and flooding and a recommendation for state insurance regulators to improve the oversight of claims adjustment activities. Congress should consider providing FEMA clear authority to obtain 1) wind damage claims information from WYO insurers, as appropriate, and 2) the policies, procedures, and instructions used by WYO insurers for determining wind damage versus flood damage when properties are subjected to both perils. Such authority would enhance FEMA's ability to monitor and reevaluate the accuracy of NFIP flood damage payments that result from the wind and flood damage apportionments and its controls over the inherent conflict of interest involving WYO insurers that sell and service both wind and flood policies. For state insurance regulators, in conjunction with NAIC, we recommend taking action to enhance the quality and consistency of standards and oversight for all types of claims adjusters.

We requested comments on a draft of this report from FEMA and NAIC. The Department of Homeland Security provided written comments on a draft of this report that are reprinted in appendix II. It concurred with our recommendation to strengthen licensing requirements for adjusters but disagreed with the matters for congressional consideration regarding expanding FEMA's statutory authority to obtain available wind damage claims information from WYO insurers and to access the WYO insurers' claims adjustment guidance. The letter notes that having such authority would place "unneeded burden and costs" on NFIP, given its current oversight of the WYO insurers. We disagree; such authority is a necessary control given the potential federal exposure to flood losses and the

inherent conflict of interest that exists when the same insurance company is responsible for determining the extent of the flood damage that NFIP must pay and the extent of the wind damage that is the responsibility of the company itself. Likewise, FEMA should be able to access the policies, procedures, and instructions used by WYO insurers and their adjusters for both flood and wind damage claims to assess and validate claims adjustment practices and damage apportionments when properties have been subjected to both perils. As we note in the report, FEMA would not have to collect such information on all claims; rather, this authority would enable the agency to request such information on an as-needed basis when uncertainties exist, such as when the physical evidence has been compromised or limited physical evidence remains. The Department of Homeland Security's written comments and our responses are discussed in more detail at the end of this letter. NAIC did not provide written comments but orally expressed general agreement with the draft's findings and recommendations. FEMA and NAIC provided technical comments that we have incorporated as appropriate.

Background

The federal government has long been a participant in addressing risks that private property-casualty insurers have been unable or unwilling to insure. One of these risks is damage due to flooding. While NFIP backs the flood insurance policy, it generally contracts the sale and servicing of the policies out to private property-casualty insurers, known as WYO insurance companies.⁵ About 96 percent of NFIP's policies are sold and serviced by WYO insurers. For a given property, the WYO insurer writing and administering the flood insurance policy on behalf of NFIP may also provide coverage for wind-related risks on the same property.

Through its program contractor, FEMA operates a reinspection program to monitor and oversee claims adjustments and address concerns about flood payments. The reinspection program's activities encompass reevaluating the flood adjustments and claims payments made on damaged property to determine whether NFIP paid the proper amount for flood-related damages. The program conducts on-site reinspections and reevaluations of a sample of flood claim adjustments.

⁵NFIP 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.

Determining the cause and extent of damages is primarily the job of insurance adjusters, who are either employed or contracted by insurance companies and generally licensed by the states. Adjusters assess damage; estimate losses; and submit required reports, work sheets, and photographs to the insurance company, which reviews the claims and approves them for payment. In general, insurance adjusters are paid on a percentage basis or fee schedule tied to the amount of damages. These adjusters can fall into several categories:

- Staff (or company) adjusters are employees of insurance companies who determine the amount of damages payable on claims under a contract of insurance.
- Independent adjusters and adjuster firms are contractors that insurance companies hire to assess damages and determine claims losses.
- Emergency adjusters are sometimes allowed by states to operate on a temporary basis to further augment the force of adjusters following a catastrophe.
- Public adjusters are hired by and work on behalf of property owners to assess damages and help prepare claims.

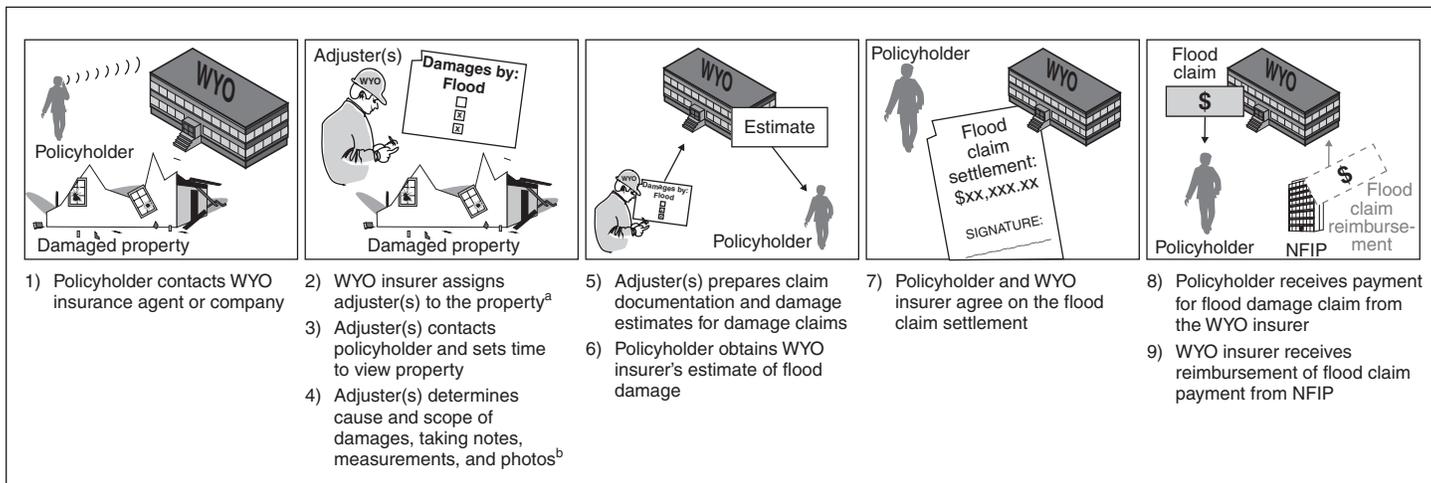
Insurance adjusters are regulated by the states, which have been granted authority by Congress to oversee insurance activities. The federal government retains the authority to regulate insurance, giving primary responsibility for insurance regulation to the states in accordance with the McCarran-Ferguson Act of 1945.⁶ State insurance regulators' oversight includes requirements pertaining to the licensing and training of insurance adjusters. In addition, adjusters that have been licensed or allowed to operate by a state can also be certified as flood adjusters by NFIP to assess flood damages on properties.

A property owner who has experienced hurricane damages can initiate a flood insurance claim by contacting the insurance agent of the WYO insurer that sold the NFIP flood policy. The agent relays the claim information to the WYO insurer, which assigns a flood claims adjuster to

⁶McCarran-Ferguson Act of 1945, Pub. L. No. 79-5, ch. 20, 59 Stat. 33 (1945), codified as amended at 15 U.S.C. §§ 1011-1015. See also GAO, *Ultimate Effects of McCarran-Ferguson Federal Antitrust Exemption on Insurance Activity Are Unclear*, [GAO-05-81R](#) (Washington, D.C.: July 28, 2005).

the case. The adjuster will then inspect the property to determine the damage caused by flooding and the extent to which that damage is covered under the flood policy. To help carry out this work, insurance adjusters commonly use software that organizes the damage information and estimates the repair or replacement costs for such damages. Factors utilized in determining loss estimates include the square footage of the building; the type of building materials; and the cost of materials and repairs at the market rate, which is subject to change. Once the assessment of a damaged property is complete, the adjuster files a report with the WYO insurance company, which reviews the claim and approves or denies it for payment to the policyholder (see fig. 1).

Figure 1: Key Flood Insurance Claims Processing Steps on Flood-Damaged Properties



Sources: GAO (analysis); Art Explosion (images).

^aThe insurance adjuster that assesses flood damages must be an NFIP-certified flood adjuster.

^bInsurance companies may also decide to hire an engineer to assess the cause(s) of damages, depending on the damage scenario.

Likewise, for wind-related damage claims on hurricane-damaged properties, property owners can contact the insurance agent or company that sold them their property-casualty policy to start the claims process. For some property owners, their property-casualty insurer for wind-related risks is the same company that serves as NFIP's WYO insurer. In such cases, both the wind and flood insurance policies will be processed

by the same insurer.⁷ In other cases, where the property-casualty insurer is a different company than the WYO insurer, claims for wind and flood damages will be processed separately by different insurers.

Both the insurance industry and NFIP incurred unprecedented storm losses from the 2005 hurricane season. State insurance regulators estimated that property-casualty insurers had paid out approximately \$22.4 billion in claims tied to Hurricane Katrina (excluding flood) as of December 31, 2006.⁸ 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. FEMA estimated that NFIP had paid over \$15.7 billion in flood insurance claims from Hurricane Katrina as of August 31, 2007, encompassing approximately 99 percent of all flood claims received.

As of September 2007, FEMA had about 68 employees, assisted by about 170 contractor employees, to manage and oversee the NFIP and the National Flood Insurance Fund, into which premiums are deposited and claims and expenses are paid. Their management responsibilities include establishing and updating NFIP regulations, analyzing data to determine flood insurance rates, and offering training to insurance agents and adjusters. In addition, FEMA and its program contractor are responsible for monitoring and overseeing the quality of the performance of the WYO insurance companies to assure that NFIP is administered properly.

We have recently completed related work highlighting concerns with payment formulas for services rendered by WYO insurers.⁹ We are also engaged in other ongoing work focused on reviewing various aspects of the oversight of WYO insurers.

⁷NFIP program contractors stated that they did not know how often the same WYO company also insured a 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.

⁸This amount represents claims reported to NAIC by property-casualty insurers 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).

⁹GAO, *National Flood Insurance Program: FEMA's Management and Oversight of Payments for Insurance Company Services Should Be Improved*, [GAO-07-1078](#) (Washington D.C.: Sept. 5, 2007).

Potential Coverage Gaps and Claims Uncertainties Can Arise When Homeowners Have Multiple Policies That Cover Different Perils

Insurance coverage for hurricane damages commonly requires the purchase of multiple insurance policies—a general homeowners policy, an NFIP policy, and in some areas, a special policy for wind damage. But even with these policies, homeowners cannot be certain that all damage resulting from a hurricane will be covered because the areas and limits of coverage differ across policies. Further, because both homeowners and NFIP policies can be serviced by a single WYO insurer, a conflict of interest exists during the adjustment process. Since Hurricane Katrina, legal disputes have been ongoing between property-casualty insurers and policyholders over damage determinations and the interpretation of policy language concerning coverage for damages that may have resulted from both wind and flooding.

Covering Hurricane Damages Often Requires Two or More Policies with Different Limits and Coverage

Property owners cannot currently purchase a single insurance policy for all hurricane-related damages because policies offered by property-casualty insurers generally exclude coverage for flood damage and sometimes may exclude coverage for wind-related damage. Property owners in flood-prone areas frequently have at least two insurance policies—for example, a homeowners policy from a private insurer and a flood insurance policy backed by NFIP. Additionally, on certain properties in coastal areas, private insurers sometimes exclude from homeowners policies coverage for wind-related damage, requiring policyholders to either pay an additional premium for wind-related risks on their primary policy or to purchase a separate supplemental policy for wind-related damages. In such cases, this supplemental coverage is typically provided by a state-sponsored wind insurance pool that has been created to address shortages in the availability of insurance for wind-related risks. Moreover, some property owners may also have excess flood insurance if the value of their home exceeds the coverage limits offered by NFIP.

Private property-casualty insurance policies differ from the government-sponsored flood insurance policy in several ways. For example, key differences exist between the level of coverage offered by NFIP and that offered under common homeowners policies. Available coverage for damages under an NFIP policy is limited by law to \$250,000 for the structure and \$100,000 for contents, although the replacement cost value of some homes exceeds such limits.¹⁰ Generally, private homeowners

¹⁰Replacement cost value is the cost to replace property with the same kind of material and construction (without deduction for depreciation). Excess flood insurance is also available in the private insurance market.

policies can cover the replacement cost value of the house, and coverage may be obtained to insure personal property, including outside property and personal belongings (e.g., trees, plants, decks, and fences), in contrast to an NFIP policy. Further, while homeowners policies often provide coverage for additional living expenses if a house is rendered uninhabitable, NFIP does not insure policyholders for such coverage, although such expenses may be offset through other disaster assistance provided by FEMA.¹¹

Insurance Coverage Gaps, Claims Adjustment Uncertainties, and Conflicts of Interest Can Materialize When Two or More Policies Cover One Event

Property owners do not know in advance whether their insurance policies will cover all damages from a hurricane, because the payments ultimately will depend on the extent to which each policy will cover the damages—that is, whether the damages are determined to be the result of hurricane winds, flooding, or some combination of both. Even property owners that purchase the maximum amount of flood insurance available through NFIP, along with other private insurance for wind-related risks, do not know whether they are completely covered until the insurers' claims adjusters determine what caused the damage. Given the differences between the coverage offered under flood insurance and the coverage offered by private property-casualty insurance, the damage determinations can be crucial. For example, a homeowner whose house is worth \$450,000 may have both a flood insurance policy and wind coverage, but flood insurance covers only up to \$250,000 in damages. If damages to the policyholder's house are severe, and all of it is determined to be from flooding, the property owner may not receive enough compensation to fully rebuild and pay for temporary housing under the terms of the NFIP flood policy.¹² But if all of the damages are determined to have been caused by wind, the homeowner may be able to fully recoup their losses and additional living expenses. Hence, insurance coverage uncertainties can arise when hurricane damages occur.

¹¹FEMA provides limited reimbursement for living expenses incurred during evacuations. To be eligible for such assistance, the home must be the primary residence of those seeking assistance. In addition, the home must either have been damaged by the disaster, or those impacted must have been prohibited from returning to it when the general evacuation order was lifted. FEMA states that the agency reviews requests for such assistance on a case-by-case basis.

¹²Excess flood insurance policies are available in the private sector and provide coverage above the NFIP limits.

Claims adjustment uncertainties include challenges that can arise in assessing and adjusting damages due to wind and flooding when the evidence of damage at the damage scene is limited or compromised. As a result of the magnitude and severity of damage from Hurricanes Katrina and Rita, evidence of the damaged structures was often limited or compromised. In some cases, buildings were completely destroyed, leaving little except the foundations. Insurance claims adjusters and industry participants we spoke with acknowledged that assessing the cause and extent of damages was more problematic when little evidence of the structure was left. Exacerbating such difficulties was the fact that adjusters commonly arrived on the damage site several weeks after Hurricane Katrina occurred, given the scope of damage. During the time between Hurricane Katrina and the arrival of the adjusters, the remaining evidence at damage scenes may have been further compromised by subsequent natural and man-made events (such as the clearing of debris from streets and roadways).

Finally, there is an inherent conflict of interest when the same insurer is responsible for assessing damages for its own property-casualty policy, as well as for the NFIP policy, each covering different perils on the same property. As part of the WYO arrangement, private property-casualty insurers are responsible for selling and servicing NFIP policies, including performing the claims adjustment activities to assess the cause and extent of damages.¹³ When the WYO insurer writes and services its own policy, along with the NFIP policy for the same property, the insurer is responsible for determining the cause of damages and, in turn, how much of the damages it will pay for and how much NFIP will cover. In certain damage scenarios, the WYO insurer that covers a policyholder for wind losses can have a vested economic interest in the outcome of the damage determination that it performs when the property is subjected to a combination of high winds and flooding. In such cases, a conflict of interest exists with the WYO insurer as it determines which damages were caused by wind, to be paid by itself, and which damages were caused by flooding, to be paid by NFIP. Moreover, the amount WYO insurers are compensated for servicing a flood claim also increases as the amount of flood damage on a claim increases—an allowance of 3.3 percent of each claim settlement amount.

¹³The WYO insurer, using either its own staff adjusters or contracted adjusters, is responsible for performing the claims adjustment functions. Additionally, insurers may contract to obtain additional engineering expertise to assess the cause of damages.

Legal Disputes Involving Policy Coverage Have Arisen Since the 2005 Hurricane Season

In the aftermath of the 2005 hurricane season, legal disputes emerged between policyholders and insurers that centered largely on the extent to which damages would be covered under a homeowners policy, as distinct from an NFIP policy, when both high winds and flooding occurred. Such disputes have been and continue to be argued and resolved through state and federal courts, as well as through mediation programs.

Many of these cases have concerned the interpretation and/or enforceability of certain property-casualty policy language in the context of challenging the cause of the damages or losses. For example, some disputes have raised the question of whether a policy's flood exclusion language clearly excluded the water-related event, such as storm surge, that caused the damages at issue. Other cases have challenged the enforceability of a property-casualty policy's anti-concurrent causation clause. Such a clause generally provides that coverage is precluded for damage caused directly or indirectly by an excluded cause of loss (for example, flood), regardless of any other cause (for example, wind) that contributes concurrently to or in any sequence with the loss. Many of these cases are still working their way through the judicial trial and appeals processes and will eventually be resolved based on the particular language of the policy, the evidence presented by both the policyholders and the insurers, and the governing state law.

State mediation efforts have been initiated to help address the backlog of unresolved claims between policyholders and insurance companies on private homeowners policies.¹⁴ These programs, particularly in Louisiana and Mississippi, have played a major role in facilitating many settlements of residential property insurance claims arising out of Hurricanes Katrina and Rita. Established after the 2005 hurricane season, these programs offer policyholders and insurers a nonbinding, alternative dispute resolution procedure to resolve claims and avoid the delays, expenses, and uncertainties of resolving the disputes through the courts. On the whole, state insurance regulators in Mississippi and Louisiana report that the majority of cases brought to mediation have been resolved.

¹⁴NFIP does not participate in these mediation programs to settle flood claims with policyholders.

Lack of Uniformity in Licensing and Training Requirements among States Creates Uncertainties about Some Adjusters' Qualifications

In spite of the importance of the insurance claims adjuster to policyholders after a national catastrophe, licensing and training requirements for adjusters vary considerably by state. Some states have no requirements for insurance claims adjusters, others have them for most types of adjusters, and many states have them for some types of adjusters but not for others. This lack of uniformity results in uncertainties over the qualifications and training of claims adjusters. Further, states may temporarily relax these requirements after a catastrophe. Claims adjusters who adjust flood insurance claims, however, must be trained and certified by NFIP. Following Hurricane Katrina, some states that lacked licensing requirements for adjusters passed laws to raise the level of oversight for adjusters.

States' Licensing and Training Requirements for Claims Adjusters Vary Widely

During our review, we found that adjuster licensing and training requirements varied considerably among states, including those along the Gulf Coast. Of the eight coastal states we contacted, most had varying degrees of licensing and training requirements for different types of adjusters during the 2005 hurricane season (Florida, Georgia, Mississippi, North Carolina, South Carolina, and Texas), while two states (Louisiana and Alabama) had no examination or continuing education requirements for claims adjusters at that time. Some of the coastal states had also instituted some common licensing requirements for staff adjusters, independent adjusters, and public adjusters, while others had varying requirements for different types of adjusters. Similarly, information gathered from industry representatives showed that licensing and training requirements varied substantially among the states nationwide. Figure 2 summarizes the varying level of requirements for claims adjusters among several coastal states, as well as recent legislation enacted in some of the coastal states impacted by Hurricane Katrina to strengthen their requirements.

Figure 2: Licensing and Training Requirements for Adjusters in Selected Coastal States as of 2007

		Adjuster			
		Staff/company	Independent	Emergency	Public
Louisiana ^a	State licensing exam	○ ^c	○ ^c		○ ^c
	Continuing education	○ ^c	○ ^c		○ ^c
	Payment scheme	Flat fee	Flat fee	Undefined	Flat fee
Mississippi ^b	State licensing exam		○		○
	Continuing education		○		○ ^c
	Payment scheme	Salary	Undefined	Undefined	% of claim/settlement
Florida	State licensing exam	○	○		○
	Continuing education	○	○		○
	Payment scheme	Salary	Undefined	Undefined	% of claim/settlement
Texas	State licensing exam	○	○		○
	Continuing education	○	○		
	Payment scheme	Fee schedule	Fee schedule	Fee schedule	% of claim/settlement
South Carolina	State licensing exam	○	○		○
	Continuing education				
	Payment scheme	Salary	Undefined	Undefined	Undefined
North Carolina	State licensing exam	○	○		○
	Continuing education				
	Payment scheme	Salary	Salary	Undefined	% of claim/settlement
Georgia	State licensing exam		○		○
	Continuing education		○		○
	Payment scheme	Undefined	Undefined	Undefined	Undefined
Alabama	State licensing exam				Not allowed ^d
	Continuing education				Not allowed ^d
	Payment scheme	Salary	Hourly	Hourly	Not allowed ^d

Source: GAO summary of information from state insurance regulators and legislation enacted after Hurricane Katrina.

^aIn 2006, Louisiana enacted both The Louisiana Claims Adjuster Act (Acts 2006, No. 783) and The Louisiana Public Adjuster Act (Acts 2006, No. 806). Beginning June 30, 2007, these Acts generally require licensure, along with a licensing examination, for staff/company adjusters, independent adjusters, and public adjusters, respectively. The latter Act prohibits public adjusters from being paid a fee contingent on or a percentage of a claim amount.

^bIn 2007, Mississippi enacted House Bill No. 1524, which provided, among other things, for the licensure and regulation of public adjusters.

^cRequirements were established after the 2005 hurricane season.

^dAlabama law prohibits public adjusters from operating independently and considers such activities as the unauthorized practice of law.

For coastal states with licensing and training requirements for claims adjusters, a state licensing examination has been the principal oversight tool used to regulate the entry of adjusters into the marketplace.

According to insurance regulators, the state licensing exam typically includes questions on insurance regulation, adjusting practices, and different kinds of insurance policies. Some states also require a certain level of continuing education before a license can be renewed, while others do not.

Continuing education requirements also vary among states for different types of adjusters. For the states we contacted, continuing education requirements were mixed, with some of the states requiring a certain level of continuing education for some types of adjusters, while other states did not have continuing education requirements. For example, during the 2005 hurricane season, staff and independent adjusters employed in Florida and Texas were required to take at least 24 hours of continuing education every 2 years, while other coastal states had no continuing education requirements for some types of adjusters.

Motivated largely by concerns about the adjustment process, some states that were impacted by the 2005 hurricanes enacted legislation to raise their level of oversight for adjusters. When Hurricane Katrina hit, Louisiana did not regulate any types of adjusters, and adjusters were able to conduct business there without a license.¹⁵ In 2006, the Louisiana State Legislature passed, and the governor signed, The Louisiana Claims Adjuster Act, which required that staff and independent adjusters become licensed beginning on June 30, 2007. Like other states, the Louisiana Department of Insurance will issue nonresident adjusters a reciprocal license as long as they are currently licensed in their home states.

In Mississippi, legislative proposals were also introduced for additional oversight requirements for public adjusters. After Hurricane Katrina, the state of Mississippi allowed public adjusters to work in the state under an emergency provision approved by the Insurance Commissioner. In 2007, the Mississippi State Legislature passed, and the governor signed, a bill to allow public insurance adjusters to operate in the state permanently and have their practices regulated, a change that requires these adjusters to get certifications, licenses, and continuing education.

¹⁵In the aftermath of Hurricane Katrina, the Louisiana Department of Insurance requested insurance companies provide the names and Social Security numbers of adjusters to the department.

In addition to licensing and training requirements, some state regulators we contacted also said they relied on insurance companies' quality control measures to help ensure the quality of adjusters. Insurance companies and adjuster firms generally provide some degree of in-house or external training for their adjusters, according to industry participants. However, insurance companies and adjuster firms we contacted generally declined to share company-specific instructions and manuals for their insurance claims adjusters, citing proprietary concerns.

In contrast to the varying requirements for claims adjusters among the states, NFIP conducts limited but uniform mandatory training to certify individuals as flood adjusters. Flood adjusters must be trained and certified annually. In addition, FEMA provides ongoing oversight of NFIP claims adjustments through its claims reinspection program. However, because independent claims adjusters must be licensed by a state to be certified as a flood adjuster, the underlying qualifications and training for adjusters that seek to become flood adjusters remain varied, as they depend on the state. In the absence of uniform state standards for claims adjusters, neither NFIP, state insurance regulators, nor policyholders can be certain of the minimum qualifications held by a claims adjuster assigned to a particular property, increasing the possibility of inconsistent claims adjustments and payments for similarly damaged properties.

States May Waive Requirements for Adjusters During Emergencies, Potentially Magnifying the Impacts of Varied State Standards

Given the lack of uniformity for adjuster licensing and training requirements among states, the qualifications and level of training of the adjusters called upon in catastrophe situations can vary considerably. A state's normal oversight requirements for claims adjusters can be weakened by nonresident licensed adjusters that are allowed to operate from states with less stringent requirements. Further, while most states have some adjuster licensing and training requirements that are applicable to some types of adjusters, these oversight measures can be waived in emergency situations, as they were in the aftermath of Hurricane Katrina.

The majority of states allow nonresident adjusters to operate within state borders as long as the adjusters are licensed in other states.¹⁶ However, differences in the qualifications and training of adjusters allowed to operate in a state can materialize when this practice of reciprocity occurs

¹⁶This information is summarized from state adjuster licensing requirements compiled by the Property Casualty Insurers Association of America.

in the absence of uniform regulatory requirements. In most of the coastal states we reviewed, nonresident adjusters were exempted from taking the licensing exams if they were licensed in their home state. Although some states have similar licensing examination requirements, oversight of adjusters, nevertheless, lacks uniformity. Issues related to the quality and consistency of regulatory requirements for insurance claims adjusters across states also exist in other aspects of insurance regulation. For other regulatory functions—such as the licensing of insurance agents—many states accept licenses from other states as long as those states reciprocate. As we have reported in other work, success with state reciprocity of licensing functions depends on the adequacy and uniformity of requirements among states.¹⁷ In the absence of adequate and consistent licensing requirements, reciprocity can reduce one state’s level of oversight to the more limited standards of another.

Additionally, all of the coastal states we contacted had provisions for allowing “emergency adjusters” to augment the normal force of adjusters by waiving the normal licensing and training requirements for adjusters, if warranted by the scope of damage. Accordingly, coastal states most impacted by Hurricane Katrina invoked emergency procedures to allow additional adjusters to operate in their states without having to meet the normal licensing and training requirements. However, a state’s oversight requirements for claims adjusters may be weakened when nonresident licensed adjusters from states with less stringent requirements are allowed to operate in states with higher standards. During our review, insurance regulatory officials and industry participants and observers acknowledged possible inconsistencies and errors in adjustments that arose, given the shortage of adjusters and the varying qualifications of those that worked in the aftermath of Hurricane Katrina.

Some states have attempted to address concerns and uncertainties over the qualifications of emergency adjusters with other varied approaches. For example, Florida, Mississippi, North Carolina, and Texas require that work performed by emergency adjusters be reviewed and certified by a sponsoring licensed adjuster or insurance company. North Carolina has set minimum guidelines for certifying adjusters on an emergency basis that take into account, for instance, their level of experience. South Carolina requires that emergency adjusters file an adjuster licensing application,

¹⁷GAO, *Regulatory Initiatives of the National Association of Insurance Commissioners*, GAO-01-885R (Washington D.C.: July 6, 2001).

while Louisiana, which had no oversight requirements for emergency adjusters during the 2005 hurricane season, now requires emergency adjusters to register their name and employment contact information but imposes no other requirements.

State insurance regulators can also use market conduct examinations to further scrutinize a company's claims adjustment processes. As we have reported in previous work, state practices for market conduct exams vary widely and are not always performed on a routine basis by most insurance departments.¹⁸ However, most states can initiate targeted examinations to assess certain company activities if they receive consumer complaints suggesting a potential issue. The types of consumer complaints received by state insurance regulators include those related to the denial of claims, the untimely processing of claims, and the misrepresentation of coverage. Some states had initiated market conduct examinations on selected companies to assess their claims handling activities tied to the 2005 hurricane season and subsequent consumer complaints. For example, state insurance regulators in Louisiana conducted several market conduct examinations on various insurers. However, according to state regulators, these examinations were focused on evaluating the timeliness of claims payments in accordance with state statutes, rather than examinations on the wind versus flood issue. In Mississippi, state regulators mentioned that market conduct examinations pertaining to claims processing activities following Hurricane Katrina were still ongoing.

Lack of Relevant Claims Data Limits FEMA's Ability to Oversee Hurricane Damage Assessments

Limited data are available for evaluating the damage assessments and claims payments when properties are subjected to both high winds and flooding and the extent of damage caused by each peril is difficult to determine. Data collected by NFIP from WYO insurers—including those that serviced both NFIP flood policies along with their own policies for wind-related risks on the same properties—include only information on damage deemed by the WYO insurers to have been caused by flooding. This limited information prevents NFIP from knowing how each peril contributed to the total damages in order to verify that flood insurance claims payments were accurate. The lack of data also limits FEMA's reinspection program because the wind damage information is relevant to understanding how all perils contributed to damages when certain

¹⁸GAO, *Insurance Regulation: Common Standards and Improved Coordination Needed to Strengthen Market Regulation*, [GAO-03-433](#) (Washington D.C.: Sept. 30, 2003).

properties were subjected to both high winds and flooding. Further, the lack of transparency over the extent of wind damage deemed to have contributed to total damages limits FEMA's ability to address conflicts of interest that arise if the WYO insurer is also the wind insurer on the property. FEMA and NFIP program officials have stated that they do not have the authority to access data on wind claims for NFIP-insured properties. NFIP program contractors also stated they cannot access WYO insurers' policies, procedures, or instructions describing to adjusters how wind damage should be determined in conjunction with flood damage when properties are subjected to both perils.

NFIP Generally Lacks Needed Data on Wind Damage Claims for Properties That It Insures

NFIP does 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, NFIP has not sought such information even when the same insurance company serves as both the NFIP WYO insurer and the insurer for wind-related risks. WYO insurers are required to submit flood damage claims data in accordance with NFIP's Transaction Record Reporting and Processing (TRRP) Plan for inclusion in the NFIP's claims database.¹⁹ In our review of data elements in NFIP's claims database, we found that NFIP does not require WYO insurers that are responsible for adjusting flood claims 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.

Specifically, the TRRP Plan for WYO insurers instructs them to include only flood-related damage 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 or partially caused by wind. 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 whether damages were divided between wind and flooding for properties that were subjected to a combination of both perils. Further, NFIP program contractors stated that they did not systematically track whether the WYO insurer processing a flood claim on

¹⁹NFIP requires each WYO company to meet the requirements of the WYO TRRP Plan (identifying claims data to be reported to NFIP) and to submit monthly financial and statistical reports. 44 C.F.R. Part 62, Appendices A and B.

a property was also the wind insurer for that property. This lack of information limits FEMA's ability to adequately oversee the WYO insurers and verify that damage paid for under the flood policy was caused only by the covered loss of flooding. In past years, the determination over the cause of damages has been an issue. For example, as we reported in 2005, following Hurricane Isabel, one of the reasons that claims for additional losses were not paid was because damage was not due to flooding, but wind-driven rain.²⁰

NFIP's normal claims processing activities were stressed during the 2005 hurricane season. For both Hurricanes Katrina and Rita, FEMA estimates that NFIP has paid approximately \$16.2 billion in claims, with average payments exceeding \$95,000 and \$47,000, respectively.²¹ As we reported in December 2006, in an effort to assist policyholders, FEMA approved expedited NFIP claims processing methods that were unique to Hurricanes Katrina and Rita.²² Some expedited methods included the use of aerial and satellite photography and flood depth data in place of a site visit by a claims adjuster for properties that likely had covered damages exceeding policy limits. Under other expedited methods, FEMA also authorized claims adjustments without site visits if only foundations were left and the square-foot measurements of the dwellings were known. Such expedited procedures facilitated the prompt processing of flood claims payments to policyholders, but once these flood claims—and others—were processed, NFIP did not systematically collect corresponding wind damage claims data on an after-the-fact basis. Without information on both wind and flood damages to certain properties subjected to both perils, NFIP has reduced assurances that the amounts it paid for flood claims were actually limited to flood damage.

FEMA officials stated that they do not have access to wind damage claims data from the WYO insurers. Accordingly, NFIP does not systematically collect data on wind damage for properties for which a flood claim has

²⁰GAO, *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).

²¹FEMA estimates that Hurricane Katrina alone accounts for over \$15.7 billion in flood insurance claims.

²²GAO, *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).

been received. Rather, FEMA officials maintain that they review the quality of claims adjustments through their reinspection program and periodic operational reviews of companies. FEMA officials that we contacted expressed different opinions concerning the need for the authority to obtain wind-related data. While some FEMA and NFIP contract officials stated that having the authority to obtain and analyze wind-related claims information would be helpful in reviewing claims, other senior FEMA officials questioned the usefulness of such information, maintaining that existing oversight activities are generally sufficient without an additional review of wind-related claims data.

Without analyzing wind-related claims information, however, FEMA's oversight process is limited for determining whether the inherent conflict of interest that exists when a WYO insurer services its own policy and the flood insurance policy on the same property is adversely affecting claims determinations. This concern has also been noted in a Department of Homeland Security's Office of Inspector General's interim report, which stated, "NFIP oversight focused primarily on whether the flood claim was correctly adjudicated with little or no consideration for wind damage as a contributing factor."²³ The work being performed by the Office of Inspector General also includes subpoenaing wind claims information from WYO insurers to reevaluate wind versus flood determinations. This work was ongoing as of the time this report was being completed.

FEMA's Reinspection Program Has Limited Ability to Validate the Accuracy of Payments on Certain Hurricane-Damaged Properties Given the Lack of Information Available on Wind-Related Damage Claims

FEMA's reinspection program, which reevaluates the adjustment process and flood payments made, does not collect information that could help enable FEMA to validate the claims payments on certain hurricane-damaged properties. The reinspection program does not systematically evaluate the apportionment of damages between wind and flooding, even when a conflict of interest exists with a WYO insurer. For example, the program does not have a means of identifying whether wind-related damage contributed to losses on the properties it evaluates or the extent of such losses. Without the ability to examine damages caused by both wind and flooding in some cases, 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.

²³Department of Homeland Security, Office of Inspector General, *Interim Report - Hurricane Katrina: A Review of Wind Versus Flood Issues*, OIG-07-62 (July 2007).

During our study, we reviewed 740 reinspection files for properties with flood claims associated with Hurricanes Katrina and Rita. We found that most of these files did not document a determination of whether or not damages were caused by a combination of wind and flooding and did not adequately document whether 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 files contained limited and inconsistent documentation concerning the presence or extent of wind-related damage on properties and lacked the documentation that would have enabled NFIP to verify that damages paid for under the flood policy were caused only by the covered loss of flooding.

Specifically, the reinspection activities focused on reevaluating the extent to which building and content damages were caused by flooding in the absence of information concerning wind-related damage. While some of the files documented damages that had been caused by a combination of wind and flooding, most did not. Around two-thirds of the 740 reinspection files did not indicate whether the damages had been caused only by flooding or by a combination of wind and flooding and did not include enough documentation for a reviewer to make such a determination. Approximately 26 percent of the files indicated that the damages were caused only by flooding, and 8 percent indicated that the damages were caused by a combination of wind and flooding. When NFIP program contractors conducting the reinspections did indicate that damages were caused by a combination of wind and flooding, insufficient documentation existed to determine the extent to which the wind damage contributed to total property damages and, hence, the accuracy of the flood damage claim.

Concerning the lack of wind damage claims data available to NFIP, we found that hurricane claims data gathered separately by state insurance regulators were of limited value for understanding how wind and flooding contributed to property damages. In the aftermath of Hurricanes Katrina and Rita, state insurance regulators in Alabama, Florida, Louisiana, Mississippi, and Texas jointly established a data call mechanism to collect aggregate claims data associated with the storms reported by property-

casualty insurers.²⁴ But such data were of limited value for assessing how wind and flooding contributed to damages because this information lacked sufficient geographic detail to be matched with corresponding flood claims data on a community-level (e.g., zip-code) or property-level basis. Rather, claims data reported by property-casualty insurers were reported on a statewide and county- or parish-level basis for different elements. As a result, the hurricane claims data collectively gathered by state insurance regulators would have been of limited benefit to NFIP to understand how both wind and flooding contributed to property damages. State insurance regulators, through NAIC, are currently developing specifications and exploring the feasibility of collecting more geographically detailed information for an updated disaster reporting system based on lessons learned from recent hurricanes and comments from interested parties about monitoring insurance claims following a natural disaster.

In the aftermath of the 2005 hurricane season, the NFIP reinspection process was also challenged by the severity and scope of the damages. Many properties were completely destroyed, making damage determinations and reevaluations of such determinations difficult. The on-site reinspections of properties with flood claims associated with Hurricanes Katrina and Rita were generally conducted several months after the event—delays that were to some extent understandable, considering the magnitude of the devastation. But the delays further limited FEMA’s ability to reevaluate the quality and accuracy of the initial damage determinations, given the ongoing natural and man-made events that continued to alter the damage scenes.

Additionally, we have previously reported that FEMA did not choose statistically valid random samples of the universe of all closed claims for its reinspection process. Therefore, the results of the reinspections could not be projected to the universe of properties for which flood claims were

²⁴This data call mechanism, the Insurance Disaster Reporting System (IDRS), 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 insurers. Components of the IDRS data call mechanism were primarily developed by the state of Florida. State insurance regulators decided to use Florida’s data collection application, since it was readily available. Regulators implemented the data call in three phases. Generally, the Phase I data were used to track the total number of claims and amount of losses tied to a storm. Phase II data further broke out the claims data by the type of damage that caused the losses. Phase III data were used to collect and track information on how many of the claims the private insurers considered closed.

made.²⁵ Accordingly, we have previously recommended that FEMA select a statistically valid sample of reinspections for its reinspection program. FEMA has agreed to implement this recommendation.

Finally, NFIP program contractors responsible for administering the reinspection program also mentioned that they do not have access to WYO companies' adjusting policies, procedures, and instructions to assess the guidance provided to their adjusters (company staff or contracted) for discerning and quantifying the damages caused by wind versus flooding. The lack of information on the specific methodologies and instructions conveyed by WYO insurers to their force of adjusters diminishes the transparency over how damages were discerned between wind and flooding on hurricane-damaged properties and the extent to which these instructions are consistent with or at odds with FEMA's instructions to adjusters. Absent such information along with the wind-related claims data, FEMA's oversight of the NFIP WYO insurers to assess the accuracy of flood claims payments is limited, particularly in cases where the WYO insurer is also the wind insurer on the same property.

Conclusions

Resolving the unique insurance issues posed by hurricanes requires actions to address numerous uncertainties. The NFIP must balance pressures to quickly pay claims to policyholders with ensuring that it is enforcing the terms of the flood policy. Uncertainties involved in this process begin with the extent of covered damages from multiple policies, contingent on the damage scenario, and continue with the claims adjustment and regulatory oversight activities that follow. As we have seen, policyholders do not know in advance of a hurricane the extent to which damages will be covered because the amount of insured losses depends on whether it is a multiperil event, how much of the damages are caused by wind and how much by flooding, and how policy language will be interpreted in accordance with relevant state laws. Other concerns can also materialize when the WYO insurer determines not only the damage caused by flooding that is covered by the flood policy, but also the damage caused by wind that is covered under its own property-casualty policy, creating an inherent conflict of interest that must be managed or mitigated. In the aftermath of Katrina, policyholders and insurance companies were and continue to be uncertain as to how current language

²⁵GAO-06-119.

on property-casualty insurance policies will be interpreted, and numerous lawsuits continue to make their way through federal and state courts.

Once an event has occurred, other uncertainties arise concerning the qualifications and training of claims adjusters. State licensing and training requirements vary considerably, and standards that do exist may be relaxed or eliminated after a major catastrophe, depending on the scope of damage. Additionally, uncertainties remain over the probability of accurately discerning the extent to which damages were caused by wind versus flooding on certain hurricane-damaged properties. The difficulty in performing this task can increase when evidence remaining at the damage scene is limited or compromised. Not surprisingly, the variations in adjusters' qualifications, coupled with limited or compromised evidence at damage scenes, foster debate and uncertainty over the way damage determinations are made, the consistency of adjustments for similarly damaged properties, and how losses are apportioned between flood and wind insurers. In the absence of uniform state standards for claims adjusters, state insurance regulators, as well as policyholders, cannot be certain of the minimum qualifications or level of professional training of a claims adjuster assigned to a particular property, increasing the possibility of inconsistent claims adjustments and payments for similarly damaged properties.

Uncertainties are also present in the oversight of claims adjustment processes, given the lack of information concerning both wind and flood damage claims for certain hurricane-damaged properties. FEMA cannot be certain of the quality of NFIP claims adjustments allocating damage to flooding in cases where damages may have been caused by a combination of wind and flooding because NFIP does not systematically collect and analyze both types of damage claims data together on a property-level basis. Although FEMA officials believe they can verify the accuracy of flood claim payments without the wind data, there are situations where additional information is warranted. Without information on the wind damage claims adjustments prepared by WYO insurers at the time they submit flood claims on hurricane-damaged properties, FEMA lacks controls to independently assess whether or not the apportionments between flood and wind damage appear reasonable. FEMA officials have determined that they currently lack the authority to access the WYO insurers' claims data and guidance to adjusters for wind-related claims to evaluate the reasonableness of the flood claims for properties that were also subject to damage from high winds. Hence, for a given property, NFIP does not know how each peril contributed to the total property damages or how adjusters working for the WYO insurers made such determinations.

As a result, FEMA cannot be certain whether NFIP has paid only for damage caused by flooding when insurers with a financial interest in apportioning damages between wind and flooding are responsible for making such apportionments.

Matters for Congressional Consideration

To strengthen and clarify FEMA's oversight of WYO insurers, particularly those that service both wind and flood damage claims on the same property, we recommend the Congress consider giving FEMA clear statutory access to:

- both wind and flood damage claims information available from NFIP's WYO insurers in cases in which it is likely that both wind and flooding contributed to any damage or loss to covered properties, enabling NFIP to match and analyze the wind and flood damage apportionments made on hurricane-damaged properties in a systematic fashion, as appropriate; and
- the policies, procedures, and instructions used by WYO insurers and their adjusters for both flood and wind claims to assess and validate insurers' claims adjustment practices for identifying, apportioning, and quantifying damages in cases where there are combined perils.

Recommendation for Action

We recommend that state insurance commissioners, acting through NAIC, enhance the quality and consistency of standards and oversight for all types of claims adjusters among states through more stringent and consistent licensing and training requirements for adjusters, including, in those states where appropriate, training to assess and apportion damages due to wind, flooding, or both.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from FEMA and NAIC. The Department of Homeland Security provided written comments on a draft of this report, which have been reprinted in appendix II. FEMA concurred with our recommendation to strengthen licensing requirements for adjusters but disagreed with the matters for congressional consideration to give FEMA clear statutory authority to obtain 1) wind damage claims information available from WYO insurers and 2) the policies, procedures, and instructions used for determining wind damage versus flood damage when properties are subjected to both perils. In oral comments, NAIC expressed general agreement with the draft's findings and recommendations. In addition, both FEMA and NAIC provided technical comments, which we have incorporated as appropriate.

FEMA stated that it believed existing oversight measures for NFIP and WYO insurers were sufficient and that statutory access to wind and flood damage claims information from NFIP WYO insurers would place an unneeded burden and cost on NFIP. FEMA also stated that it did not believe NFIP needs the wind estimate or data to determine the amount of flood damage that occurred. It also noted that additional unnecessary costs would be incurred to access and analyze wind damage claims information from WYO insurers. We disagree. Because of the inherent conflict of interest that exists when WYO insurers are the property-casualty insurers for wind claims and are also responsible for servicing the flood claims on the same properties, FEMA must ensure that its internal controls are sufficient to minimize the potential adverse impacts of this conflict on the accuracy of damage determinations and flood claims payments. Accurately determining claims payments is particularly important, given the likely eventuality that FEMA would need to draw on the U.S. Treasury to pay flood losses that exceed the funds available from premiums.

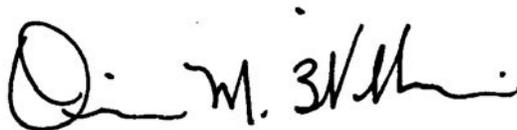
We do not suggest that FEMA collect and analyze wind claims data for each claim or even each flood event. Rather, we recommend that FEMA have the ability to access wind damage claims information when it is available from the WYO insurer—that is, in circumstances when the WYO insurer is responsible for servicing both the wind and flood policies on the same property and when uncertainties exist, such as when the physical evidence has been compromised or limited physical evidence remains. Obtaining wind damage claims information that is already available from WYO insurers establishes proper transparency over the adjustment process when both wind and flooding contribute to damages without an unreasonable or costly burden. As long as a conflict of interest exists with a WYO insurer that services its own policy for wind-related risks along with the NFIP flood policy on the same property, additional controls are warranted. When properties are subjected to both wind and flood perils, particularly in cases where uncertainties exist due to limited or compromised evidence at the damage scene, collecting enough information to understand whether or not the WYO insurer is also the wind insurer for the same property and, if so, the extent of damage it determined to be caused by wind versus flooding, is key to maintaining transparency over the adjustment process. Furthermore, when the same insurance company has already determined the amount of damage caused by wind and flooding for a given property, obtaining and assessing this available information should not be cost prohibitive for FEMA or WYO insurers. The authority to access policies, procedures, and guidance used for determining wind versus flood damage would enable FEMA to have a

more complete understanding about how concurrent damages are handled by the WYO insurers. Such information would strengthen FEMA's oversight and ability to identify abuses and better ensure the accuracy of flood payments made.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Administrator of FEMA; the Chief Executive Officer of NAIC; the Chairman of the House Committee on Financial Services; the Chairman and Ranking Member of the Senate Committee on Banking, Housing, and Urban Affairs; the Chairman and Ranking Member of the House Committee on Homeland Security; the Chairman and Ranking Member of the Senate Committee on Homeland Security and Governmental Affairs; and other interested committees and parties. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Orice M. Williams". The signature is stylized and cursive.

Orice M. Williams
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

To evaluate how key insurance coverage issues can arise when multiple insurance plans are tied to a hurricane-damaged property, we contacted and collected information from the Federal Emergency Management Agency (FEMA), National Flood Insurance Program (NFIP) contractors, state insurance regulators, the National Association of Insurance Commissioners (NAIC), property-casualty insurers, state-sponsored wind insurers, insurance agents, claims adjusters, industry associations, and mediators. This work encompassed reviewing key areas and limits of coverage from insurance policies offered through NFIP and property-casualty insurers to identify potential gaps in coverage that can arise based on the terms of such policies and the nature of the damage. Additionally, we reviewed the roles and responsibilities of write-your-own (WYO) insurers that service NFIP policies to identify whether a conflict of interest exists with a WYO insurer in certain circumstances.

To evaluate state insurance regulators' oversight of the licensing and performance of loss adjusters, we contacted and collected information from state insurance regulators, NAIC, property-casualty insurers, state-sponsored wind insurers, claims adjusters, and industry associations. We collected and compared licensing and training requirements for claims adjusters provided by state insurance regulators in several coastal states, incorporating information on requirements that existed prior to the 2005 hurricane season, as well as subsequent legislation enacted by some coastal states to strengthen oversight requirements for adjusters. We also discussed the activities, challenges, and damage scenarios encountered by claims adjusters in the aftermath of recent hurricanes with state regulators, FEMA and NFIP program officials, and industry participants. We also requested information from some property-casualty insurers and claims adjustment firms on their guidance (policies, procedures, manuals, and instructions) to claims adjusters on how to discern and quantify wind versus flood damages when properties are subjected to both perils. Industry participants declined to provide such information, citing proprietary concerns and ongoing litigation. This work included on-site fieldwork in Florida, Illinois, Louisiana, Mississippi, North Carolina, Pennsylvania, South Carolina, and Texas.

To evaluate the completeness of the information that NFIP collects and analyzes in order to determine whether damage determinations and flood payments made accurately reflect the actual distribution of losses between wind and flooding, we reviewed claims information collected by NFIP from WYO insurers serving the flood claims. This work included reviewing the type of information routinely collected from WYO insurers through NFIP's Transaction Record Reporting and Processing (TRRP) Plan. In addition, we obtained information on FEMA's reinspection program that is used to reevaluate the quality of NFIP claims that have been processed. We assessed the type of information used by NFIP to validate the damage determinations made by WYO insurers, reviewing a statistically valid sample of files (740) of reinspections that NFIP conducted on selected properties from Hurricanes Katrina and Rita. We also reviewed hurricane claims data collectively gathered by several state insurance regulators to ascertain the extent to which such information would be useful for assessing wind versus flood damage determinations made on properties. We conducted our review between May 2006 and November 2007 in accordance with generally accepted government auditing standards.

Appendix II: Comments from the Department of Homeland Security

U.S. Department of Homeland Security
Washington, DC 20528

US GAO

200 DEC -5 PM 1:21



**Homeland
Security**

December 4, 2007

Ms. Orice Williams
Director, Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Williams:

RE: Draft Report GAO-08-28, National Flood Insurance Program: Greater
Transparency and Oversight of Wind and Flood Damage Determinations
Needed (GAO Job Code 250287)

The Department of Homeland Security (DHS) appreciates the opportunity to review and comment on the draft report referenced above. The U.S. Government Accountability Office (GAO) raises a matter for Congressional consideration and makes one recommendation to state insurance commissioners. No recommendations are specifically directed to DHS or its component, the Federal Emergency Management Agency (FEMA).

FEMA officials agree with the recommendation to strengthen the licensing requirements for adjusters, thereby enhancing the quality and consistency of standards and oversight for claims adjusters among states. FEMA's National Flood Insurance Program (NFIP) requires uniform standards throughout the country, at least five years of property insurance adjusting experience, and attendance at a claims presentation annually. These requirements have served the program well. The operation of the insurance claims process in the private insurance industry and in the NFIP would improve if the states' insurance departments worked through the National Association of Insurance Commissioners to strengthen licensing and training of adjusters.

FEMA officials disagree with GAO on the matter for Congressional consideration. Specifically, GAO recommends that Congress consider giving FEMA clear statutory authority to obtain wind damage claims information from write-your-own (WYO) insurers and the policies, procedures, and instructions used by write-your-own insurers for determining wind damage versus flood damage when properties are subjected to both perils. GAO believes the statutory access will strengthen and clarify FEMA's oversight of write-your-own insurers. FEMA officials disagree and feel that the existing means of auditing and managing the National Flood Insurance program and write-your-own insurers are sufficient.

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FEMA officials believe that statutory access to wind and flood damage claims information from the NFIP's write-your-own companies would place an unneeded burden and cost on the National Flood Insurance Program. Existing processes proved to be sufficient in determining properly adjusted claims associated with hurricanes Katrina and Rita. There has been no documented discovery that claims were handled inappropriately when it came to wind and flood damages. In fact, GAO indicated during this engagement and the DHS Office of the Inspector General stated in the interim report Hurricane Katrina: A Review of Wind vs. Flood that they could not find evidence that NFIP paid more than obligated to policyholders. The program handled an unprecedented number of claims in 2004 and 2005 with little complaint and very few lawsuits.

FEMA officials do not believe the NFIP needs the wind estimate or data to determine the amount of flood damage that has occurred. Claim adjustment is not an allocation of damage to various causes of loss. It is the determination of damages by the insured cause of loss that is the subject of the insurance. In this determination insurance claim adjusters prepare a room-by-room, line-by-line, itemized, unit-cost estimate of only the flood damage. Since photographs of the building are required, the experienced company examiner can determine if damage above the flood water line, i.e., damage from wind is included in the loss settlement. If it appears that wind damage was paid and it is not fully explained in the adjuster's narrative report, the estimate is returned to the adjusting firm to be reevaluated or explained. In the rare cases (more prevalent in Mississippi as a result of hurricane Katrina) where the property was totally destroyed, both wind and flood could have contributed to the same damage. Flood insurance paid the claim when there was no evidence to contradict that the property was demolished by a storm surge. However, if it was determined by solid evidence that damage was caused first by wind to the roof and siding, and then by flood to the foundation and lower framing and flooring, the flood insurance paid flood damage and the wind insurance paid wind related damage.

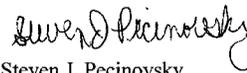
Additional cost would be incurred by the program if independent flood insurance adjusting firms are to be responsible for reviewing the wind claim file or estimate on each flood loss in which wind may have contributed. These independent flood insurance adjusting firms would most certainly renegotiate fee schedules upward for this additional work. The marginal value of such data would be costly. If FEMA or its contractor is to review and evaluate wind claim files as part of the reinspection process, additional staff would be needed. If FEMA is to review wind claim files as part of its operation review process, additional insurance reviewers will be needed for this work as well.

FEMA would still have no authority to demand private wind claim data of companies not participating in the WYO program even if FEMA is given the statutory authority to require the companies participating in the WYO program to provide their wind claim data and procedures. The non-participating companies would likely be forced to legally challenge any requirement to provide their private claims data to the Federal government if requested to do so. If they are successful in this challenge, requiring this information only of WYO companies would create an inequity. In addition, the logistical problems and costs associated with requiring a company to copy a wind file and provide it to the NFIP would be onerous. This would especially be the case for those WYO companies

providing only the wind coverage. The WYO company providing the flood coverage may not know the identity of the WYO company providing the wind coverage.

At the recommendation of GAO in a previous report addressing Katrina related claims handling (GAO-07-169 issued in December 2006), FEMA has improved its re-inspection program through random sampling techniques used to determine which claims are to be re-inspected. In addition to implementing this recommendation, additional staff is being hired this year, FY 2008, to conduct more in depth operational reviews of the WYO claim files. As with any effort that increases the number of inspections or reviews, additional personnel are needed to meet this challenge.

Sincerely,



Steven J. Pecinovsky
Director
Departmental GAO/OIG Liaison Office

MMcP

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Orice M. Williams, (202) 512-8678 or williamso@gao.gov

Staff Acknowledgments

In addition to the contact named above, Lawrence D. Cluff, Assistant Director; Tania Calhoun; Emily Chalmers; Rudy Chatlos; Chir-Jen Huang; Barry Kirby; Kristopher Natoli (intern); and Melvin Thomas made key contributions to this report.

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