

STATEMENT
OF
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U.S. DEPARTMENT OF HOMELAND SECURITY

BEFORE
THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
SUBCOMMITTEE ON HOUSING, TRANSPORTATION, AND COMMUNITY
DEVELOPMENT
U.S. SENATE
WASHINGTON, D.C.

**“THE FLOOD INSURANCE CLAIMS PROCESS IN COMMUNITIES AFTER SANDY:
LESSONS LEARNED AND POTENTIAL IMPROVEMENTS”**

Submitted
By

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Introduction

Good morning Chairman Johnson, Ranking Member Crapo and Members of the Subcommittee, I am Craig Fugate, Administrator for the Department of Homeland Security's (DHS) Federal Emergency Management Agency (FEMA). I appreciate the opportunity to be here today to discuss the National Flood Insurance Program (NFIP) and claims paid as a result of Hurricane Sandy.

More than 144,000 NFIP policyholders submitted notices of flood loss stemming from Hurricane Sandy, and the NFIP has paid out more than \$8.1 billion in flood claims to enable these policyholders to rebuild homes, businesses and communities. These policyholders made the proactive decision to protect themselves by investing in flood insurance. We have an obligation to these insured survivors, and to the taxpayers, to administer this program well and we take this responsibility very seriously.

Since Hurricane Sandy made landfall in 2012, FEMA's Federal Insurance & Mitigation Administration (FIMA) has been hard at work to help in the recovery, processing Hurricane Sandy-related insurance claims, and implementing the Biggert-Waters Flood Insurance Reform Act and the Homeowners Flood Insurance Affordability Act (HFIAA).

At this point, more than 99 percent of the flood insurance claims related to Hurricane Sandy that were filed by homeowners have been closed. There are only approximately 640 claims still outstanding.

In this testimony, I will discuss the NFIP and, in particular, our claims and appeals processes, policies, and successes.

Claims Related to Hurricane Sandy

FEMA moved quickly to process Hurricane Sandy-related claims. The average claim payment related to Hurricane Sandy is \$61,000, with the NFIP paying claims totaling more than \$8.1 billion.

When Hurricane Sandy made landfall, 236,000 NFIP policies were in place in New Jersey. As a result of the storm, 74,000 Hurricane Sandy claims were made in New Jersey. Of those, only 1,300 were appealed. Differences have been resolved among the adjusters, the policyholders, and the policyholders' contractors and local building materials suppliers. Based on preliminary data, we expect there may be only 453 Sandy lawsuits filed in New Jersey. This means that 98.2 percent of the claims were resolved.

In New York, 169,000 policies were in place when Hurricane Sandy hit. As a result of the storm, 57,000 claims were made in New York. Of those, only 885 were appealed. Based on the

preliminary data, we expect there may be only 400 Sandy lawsuits filed in New York. This means that 98.5 percent of these claims were resolved. The remaining open claims are due to mitigating factors such as ongoing litigation, requests for additional payment, or outstanding requests for Increased Cost of Compliance (ICC) benefits.

NFIP policyholders may also be eligible for up to \$30,000 in ICC coverage to bring their building into compliance with their community's floodplain ordinance. Elevation, relocation, demolition, and flood proofing are all covered options under ICC coverage.

In New Jersey, 7,000 policyholders submitted claims for ICC coverage and the NFIP has paid out \$69 million thus far. In New York, 1,500 policyholders submitted claims for ICC coverage and the NFIP has paid out \$12 million thus far.

Efforts to Process Claims Rapidly Post-Sandy

The NFIP effectively responded to the post-disaster needs of its policyholders by creating a rapid claims process and by instituting programmatic changes that significantly reduced the procedural burden on policyholders. For example, we deployed our Director of Claims and other key NFIP leaders to the impacted area where they worked directly with the States to find ways to accelerate assistance and payments to policyholders. These changes included:

- Authorizing advance payments of up to \$5,000 for claims prior to meeting with adjusters for inspections;
- Authorizing another advance payment of up to \$25,000 for certain mechanical elements of the building to get heating and electricity restored; and
- Authorizing an additional \$5,000 for necessary permanent repairs to doors and windows to secure a given building once heating and electricity were restored.

These claim advances, known as the 5/25/5 initiative, enabled policyholders to get back into their homes as soon as possible with necessary heat and electricity. Additionally, we extended the grace period for payment of NFIP renewal premiums. We also gave policyholders extensions to file their proof of loss statements. For Hurricane Sandy, NFIP policyholders have up to two years after the date of loss to file their proofs of loss.

In addition, the NFIP established community Flood Response Offices in New York and New Jersey to provide services to NFIP flood-certified adjusters, as well as Adjuster Certification Workshops in New Jersey. On-site Adjuster Briefings also educated an expanded corps of flood-certified adjusters on program changes made specifically to meet the needs of communities impacted by the storm. To bolster the numbers of adjusters who were able to respond to Hurricane Sandy claims, the NFIP implemented emergency adjuster certification for adjusters who were actively flood certified during the past two years, granting them a 12 month certification extension. This emergency adjuster certification made an additional 5,000 adjusters available to handle the large influx of claims related to the storm.

Early on, the Associate Administrator of FIMA went to the impacted states with senior leadership and met with state emergency management officials and state insurance commissioners to identify ways to get claims resolved expeditiously and to identify any concerns. The NFIP also deployed expert staff to work in the Governor's Office in New Jersey, worked closely with the Governor's office in New York, and sent experts to work with the FEMA Joint Field Offices in New Jersey and New York.

Increased Borrowing Authority

When Hurricane Sandy made landfall, the NFIP owed the U.S. Treasury \$17 billion to cover losses stemming from Hurricanes Katrina and Rita. Existing authorities only allowed the NFIP to borrow an additional \$3 billion before reaching the \$20.7 billion cap. The NFIP used modeling from previous hurricane flood events and geospatial technology to estimate potential claims as a result of Hurricane Sandy, and estimated the borrowing cap could be hit as soon as early January 2013.

On December 31, 2012, Congress amended the National Flood Insurance Act of 1968 (NFIA) to increase FEMA's borrowing authority from \$20.7 billion to \$30.4 billion. This enabled FEMA to cover losses stemming from Hurricane Sandy. The President signed this bill into law (Pub. L. No. 113-1) on January 6, 2013, increasing FEMA's borrowing authority and allowing the Agency to continue paying flood insurance claims from Hurricane Sandy. We are grateful to Congress for this legislation, which was part of the supplemental the administration requested.

National Flood Insurance Program Background and Coverage Basics

National Flood Insurance Program Background

Established by Congress in 1968, the NFIP helps communities better understand their flood risk, and provides affordable flood insurance to help lessen the devastating consequences of flooding in communities that agree to adopt and enforce floodplain ordinances consistent with the criteria developed by FEMA for sound land use in the floodplain. In 1973, Congress amended the NFIP to prohibit Federally-backed lenders from making loans secured by property located in a special flood hazard area unless the property was covered by flood insurance for the life of the loan.

The NFIP serves as the foundation for national efforts to reduce the loss of life and property from flood. The program identifies areas of special flood hazards and flood risk zone data, and through its floodplain management criteria and grants, mitigates the long-term risks to people and property from the effects of flooding, and offers flood insurance in participating communities.

The NFIP works closely in partnership with more than 80 participating private insurance companies – commonly known as Write Your Own (WYO) companies – to market, sell,

administer and adjust claims for policyholders. By encouraging sound floodplain management efforts, the NFIP is estimated to save the nation \$1.7 billion annually in avoided flood losses.

The NFIP supports 5.2 million policies, representing \$1.2 trillion of coverage in force. The average claim paid is approximately \$61,000.

Coverage Basics

The NFIP pays claims for direct physical loss by flood to the policyholder's insured property. For family dwellings that house one to four families, the NFIP offers up to \$250,000 in direct physical loss due to flood, and up to \$100,000 for contents coverage with a deductible. When a loss is covered under the policy, the NFIP will only pay that part of the loss that exceeds the deductible. The same is true for contents coverage, which has a separate deductible.

NFIP Replacement Cost Value and Actual Cash Value

Property insurance contents claims are settled using two different methods.

The Actual Cash Value settlement (ACV) is at the replacement cost at the time of loss, less the value of its physical depreciation. This means if the policyholder has a ten-year-old couch that can be replaced on the date of loss for \$2,000 but the physical depreciation on the date of loss due to wear and tear and the age of the piece is \$1,000, the ACV settlement will be \$1,000. Put simply, the couch was worth \$1,000 on the date of loss. To pay more than the item is worth, especially in a residual market, has been long considered to be the policyholder's windfall.

The Replacement Cost Value (RCV) settlement is based on the replacement cost of the item at the time of loss without any deduction for physical depreciation. In the above "couch" example, if an RCV endorsement is purchased by the owner, that claim would be settled at \$2,000 rather than the ACV of \$1,000. Some RCV contents endorsements limit the payment to a multiple of the ACV. In the above, even if there was a limit of twice the ACV, the full \$2,000 would be paid. However, if the couch was older and in worse condition than in this example, the full RCV might not be paid.

The cost of an RCV contents policy would significantly increase the premium required for contents coverage and would also be very expensive for the NFIP. All of this would translate into higher premiums for contents coverage.

In all cases, the value of the NFIP insured building does not include the value of land or any other improvement (building or non-building structure) on the same parcel of land.

The NFIP policy is an actual cash value (ACV) policy for all building and contents, with very limited exception applicable to primary residential buildings insured up to 80 percent of the dwelling's full replacement value. ACV means settlement amounts are based on the actual cash

value of the property less depreciation at the time of loss for all building and content claims. Paying only the actual value of property on the date of loss is typical for many residual market insurance programs, especially those, like the NFIP, that are premium sensitive.

Building claims under the terms of the Residential Condominium Building Association Policy (RCBAP) are settled at RCV, subject to a coinsurance clause, that allows the policyholder to be a coinsurer in return for purchasing building limits that are less than 80 percent of the full replacement cost of the building or the maximum NFIP limits available, \$250,000, times the number of units in the building.

All other buildings are insured at ACV. Building depreciation is also physical depreciation because of age, wear and tear. In a building, for example, elements like paint and wall covering will depreciate considerably more quickly than framing wood. However, deteriorated framing lumber with damage that is not associated with the current flood will not be worth as much as the same age wood that had not deteriorated.

HVAC systems and water heaters also have shorter life spans than framing. In all buildings, the condition of materials is considered in determining the depreciation and ultimately the dwelling's ACV. This could mean several hundred dollars, and in some cases of a building in poor condition it could mean a difference of thousands of dollars in claim payments, but would be commensurate with the actual value of the building.

For eligible principal residences, the NFIP will settle building claims based on replacement cost values. This means the NFIP will pay to repair or replace the damage to the dwelling after application of the deductible and without deduction for depreciation. FEMA does not offer replacement coverage for contents. Were FEMA to offer replacement coverage for buildings and contents, it would result in significantly higher premiums.

All NFIP claims are individually adjusted to give personal attention to each policyholder's losses and an NFIP flood certified adjuster is assigned to each claim. Building and contents claims both require a site visit. The determination of physical depreciation requires the adjuster to not only make a depreciation determination based on the age of either a contents item or a building element, but also to take into consideration the condition of the item or element on the date of loss. Often the adjuster will find items or elements that have been purchased or installed for an extended time, but are in pristine condition. In these cases, only a small amount of depreciation will be charged. Also, relatively recent purchases or installations may be in poor condition requiring a heavier depreciation charge. The adjusters are experienced in these determinations, which add an additional degree of fairness to the ultimate ACV of a contents item or building element.

Other Coverage Factors

Among other exclusions, the NFIP excludes coverage for decks and provides limited coverage in basements.

Much like traditional homeowner's policies, the standard flood insurance policy includes a clause that requires the insurer – in this case the NFIP – to name the policyholder and any known mortgagee on all Building, Coverage A claim payments. The NFIP must include the lender's name on these payments to protect their collateral allowing continued lending in flood-prone areas.

In addition, for eligible risks, some private insurance markets provide citizens flood insurance for coverage in excess of the maximum NFIP limits.

Claims Process and Improper Payments

Claims Process

FEMA is committed to efficiently and quickly resolving claims with the help of its WYO partners, with the ultimate goal of getting all funds that can be paid legally into the hands of eligible policyholders as soon as possible. All insurers of real property and their contents are similarly concerned about getting claim funds in the hands of their policyholders as quickly as possible.

The claims process was adjusted for Hurricane Sandy survivors to modify the proof of loss filing requirement. (Steps 10-14 represent minor modifications to the regular claims process to represent proof of loss – normally the proof of loss is due 60 days after the date of loss.)

The claims process is as follows:

1. The policyholder calls their insurance agent to report the loss.
2. The policyholder's insurance agent reports the claim to either the WYO Company or the Direct Servicing Agent (DSA).
3. The WYO Company/DSA ("insurer") verifies that coverage was in force on the date of loss.
4. If coverage was in force before the flood was in progress, the insurer assigns the claim to an independent claims adjusting firm hired by the insurer.
5. The adjusting firm assigns the claim to an independent NFIP flood-certified adjuster hired by the adjusting firm.
6. The adjuster contacts the policyholder within 24 to 48 hours to schedule an appointment to visit the policyholder's property, with the visit itself usually occurring within 72 hours of the assignment.
7. The adjuster meets with the policyholder at the property. During this scoping visit, which can last hours or several days for larger projects, the adjuster will:

- a. Inspect the property to verify that direct physical loss by or from flood has occurred (as defined in the Standard Flood Insurance Policy (SFIP));
 - b. Offer to recommend an advance payment (if appropriate). The adjuster must take care to consider the size of the recommended advance against the probable loss and the deductible;
 - c. Scope the loss, to include measuring, taking pictures, diagramming, and noting specific damage, and documenting serial and model numbers of damaged major appliances and electronics;
 - d. Meet with the policyholder to discuss the policy, explain the claim process, answer any question, and establish reasonable expectations;
 - e. If the policyholder also has contents coverage, the adjuster explains the contents process and provides inventory sheets to list the damaged contents, the current replacement cost value, age, and other details; and
 - f. If applicable, identify the need for expert opinions from engineers regarding foundation damage and accountants or salvors for commercial stock or inventory claims.
8. After completing all assigned scoping visits, the adjuster writes the NFIP flood claim repair estimates and closing papers, which are detailed and contain room-by-room, line-by-line estimates of flood damage.
 9. The adjuster sends a copy of the completed estimate to the policyholder and informs the policyholder that the estimate is only a recommendation. Only the insurer has the authority to determine what will actually be paid.
 10. The adjuster sends a copy of the completed estimate, contents claim and closing papers to the insurer.
 11. The insurer examines the adjuster's closing documents to verify that the adjuster's recommended payment is correct and is the maximum amount that can be paid legally.
 12. The WYO Company/DSA then makes the payment to the policyholder. Payment is typically made in two checks – one for building and one for contents. The building claim check must name any mortgagee known at the time of payment
 13. If the policyholder considers the payment inadequate, he/she must submit to his/her insurer a complete, proof of loss signed and sworn to by the policyholder attaching all documentation supporting the additional requested amount should be sent to the insurer.
 14. The insurer must consider the valid proof of loss and determine whether additional reimbursement is appropriate.

Improper Payments

FEMA is the steward of federal funds under the NFIP and is committed to reducing and eliminating waste, fraud, and abuse. FEMA and WYO companies take this responsibility very seriously. Particular focus was placed on this priority after Hurricane Katrina, when overpayments occurred and FEMA subsequently built a greater number of safeguards into

programs across the agency. These changes have decreased improper payments over time, and increased confidence in the programs that are designed to assist survivors. FEMA tracks all improper payments through an audit of payments consistent with the Improper Payment Information Act. As demonstrated in the chart below representing NFIP payments, improper payments have decreased over time due to strengthened oversight and a commitment to educating WYO companies on potential penalties for non-compliance. The data collected does not differentiate overpayment, underpayment or fraud.

Fiscal Year	Allocated Improper Payments Percentage	Threshold
2008	6.38% (FEMA Improper Payment Rate)*	2.5 % (Threshold)** (first year tracked)
2009	2.22%	2.5%
2010	1.21%	1.5%
2011	0.75%	1.5%
2012	0.02%	1.5%

*These are FEMA's results for the years of its participation. This tracking does not differentiate underpayments, overpayments or fraud.

The NFIP claims mechanism incentivizes adjusters to recommend accurate claims payments, and pay accurate claims quickly. Adjuster compensation amounts are on a schedule of payments based on the amount the policyholder is paid. NFIP insurers receive 1.5 percent of paid claims for their Unallocated Loss Adjustment Expenses, those expenses that cannot be allocated to an individual claim, for instance, the opening and operation of a catastrophe office. Neither the adjusters nor the insurers get paid until the policyholder gets paid.

While underpayments are rare, they are treated as a critical error in dealing with the WYO company at fault and closely monitored through an auditing process. If an audit finds that a WYO company has made improper payments in 20 percent or more of their claims, FEMA requires a follow up audit within 12 months. This process helps ensure proper oversight.

Additionally, complaints and concerns are tracked and assessed during operational reviews of WYO companies.

Proof of Loss Extension

The NFIP policy requires policyholders to submit a valid proof of loss with supporting documentation to the NFIP insurer within 60 days from the loss. For Hurricane Sandy, FEMA extended the deadline for submitting a proof of loss from 60 days to 24 months after the loss.

Appeals process

Once the NFIP insurer has issued a final written denial, in whole or part, of a claim, the policyholder may appeal the denial to FEMA. This process is detailed in the *NFIP Flood Insurance Claims Handbook*, which is provided to the policyholder.

Prior to filing an appeal, policyholders should:

1. Try to resolve coverage issues with the adjuster or the adjuster's supervisor.
2. If the adjuster's supervisor can't resolve your issues, the policyholder should contact the NFIP insurer's claims representative and ask for assistance.
3. If policyholder still has questions or concerns, the policyholder should send the formal appeal along with the supporting documentation directly to the Associate Administrator for the Federal Insurance and Mitigation Administration.
4. Prior to issuing an appeal decision, the Associate Administrator may request additional documents from the policyholder or the insurer and may conduct a re-inspection. After gathering the documentation, the Associate Administrator will issue written appeal decision.
5. A policyholder who does not agree with the appeal decision has the option of filing suit against the NFIP insurer within one year of the date the insurer denied the claim.

Of the more than 144,000 insurance claims received in the aftermath of Hurricane Sandy, 2,800 or 1.9 percent have been appealed. This large influx of appeals caused a backlog that FEMA worked quickly to resolve. A monthly plan was established to resolve the issue, which involved leveraging existing claims resources as well as bringing in additional claims, correspondence, and quality control resources. Because of these efforts, this backlog was cleared in January 2014.

As of July 11, 2014, there were 122 total outstanding NFIP claims appeals and there were none that are over 90 days old.

Conclusion

Through the NFIP, tens of thousands of survivors better understand how to mitigate their risk and when a flood does occur, have received payments that are helping them to rebuild their homes, businesses and communities. FEMA has an obligation to these survivors and to be good stewards of taxpayer dollars. We take this responsibility very seriously and have put a process in place that effectively settles legitimate claims and has a low improper payment rate.

We are grateful to Congress for the supplemental borrowing authority provided in the aftermath of Hurricane Sandy, and we look forward to working with Congress as we close out the few remaining claims.