

RECOMMENDATIONS FOR CHANGE

TO IMPROVE FAIR AND ACCURATE HANDLING OF CLAIMS  
FOR INSURED PROPERTY OWNERS  
IN THE CASE OF FLOOD DISASTER  
AND

TO IMPROVE THE OPERATION AND FOUNDATION  
FOR FEMA WITH REGARD TO NFIP

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# INTRODUCTION

While many aspects have been researched, studied and published regarding the National Flood Insurance Program (NFIP), the need for oversight has been absent in these reports. It is universally understood that the need for flood insurance will continue, and will actually increase over time. Without policy, procedure and oversight changes, the program will continue to financially burden federal and state resources. This paper will address these issues from the perspective of the insured, the agent/broker and the insurance expert as well as make recommendations for changes that will tip the scales back to the programs' intended outcome.

Having homes and offices in New Orleans, LA. and Marlboro, N.J. I have personally been involved as an insured as well as a working insurance expert and consultant helping homeowners with their insurance claims and assisting attorneys and their clients with legal cases fighting claims as a result of Hurricane Katrina and Hurricane Sandy. These assignments have given me a front row seat to tactics used by insurance companies that qualify as abuse and deception in order to deny and under pay legitimate claims. These abuses cost the insured property owners, the taxpayer, the Federal Government, FEMA and NFIP untold billions of dollars while allowing private insurance companies and lawyers to profit in the process, often times at the government's expense.

## SUMMARY

This paper will provide background, explore the current actions of FEMA and insurance companies, and explore the winners and losers as well as present changes and suggested oversights to prevent ongoing abuses.

- The current state of flood insurance for property owners
- How the Federal Government, NFIP and FEMA is losing
- How property owners and insured's are losing
- How private insurance companies are winning
- How law firms are winning
- How to correct the abuses of the insurance writing companies and FEMA.

## **BACKGROUND**

In 1968, Congress created the National Flood Insurance Program (NFIP). The primary purpose of this groundbreaking legislation was to assist property owners with the ability to buy flood insurance to protect themselves from financial ruin as a result of flood disasters. This legislation required participating communities in the NFIP program to adapt and enforce ordinances that met or exceeded FEMA requirements to reduce the risk of flooding.

While the program was heralded as a positive government program, and there is no doubt that the Federal Government acted with good intentions on behalf of property owners, today the Act has been amended, changed, rewritten and is now saturated with confusion leaving insurance companies with opportunities to improve profit margins at the tax payer's expense. With little oversight and a negligible threat of sanctions, the tactics employed by insurance companies frequently go unchallenged, and even after losing in a court battle, there are commonly no repercussions other than paying claims and damages.

The only way to purchase flood insurance from 1968 to 1983 was directly through NFIP, which was administrated by FEMA. To expand participation in the program, in 1983 FEMA authorized insurance companies to Write Your Own policies (WYO). Additionally, the program was expanded to authorize insurance companies to adjust flood claims on behalf of the federal government. At the onset, such a program would appear to be a sound approach to expand the program; however, the outcome has been one that has caused confusion for homeowners and opened opportunities for insurance companies to profit at the expense of both the insured property owners and the government.

Insurance companies now write flood policies under their own names. This actually is misleading to property owners as they are left with a misunderstanding that there are differences in coverage and premium offerings, even though insurance companies are charging the same premiums and providing the same coverage as the direct program.

- The program is structured so that the insurers receive an expense allowance for policies written and claims processed; the federal government retains responsibility for underwriting losses.
- From 1991 to 1995, a federal policy fee of \$25 was applied to flood policies, which in 1995 increased

to \$30.00. The flood policy fees are collected to generate the funds for FEMA salaries, expenses and to mitigate costs.

- NFIP borrows money from the U.S. Treasury in order to fund the losses, and as of this writing, is unable to repay the money borrowed.<sup>1</sup>
- Therefore, claims (losses) have, by millions of dollars, exceeded the collection of the policy fees, which have been increased over time. Yet, the insurance companies continue to write the policies, as they do not suffer any losses.<sup>1</sup>

## **CHALLENGES & RECOMMENDATIONS**

### **CHALLENGES – THE ADJUSTERS:**

In the aftermath of a natural disaster, it is not unusual for insurance companies to contract out of state adjusters to assist with the additional volume of claims. While this tactic may help with the labor shortage, it poses an entirely different set of challenges that alters the outcomes of claims and leads to a high volume of challenges from insureds.

- Adjusters from another part of the country have an entirely different experience base as to the costs of replacement values, labor and material than an in-state adjuster.
- Adjusters rely on software programmed with data based on the state of their operation. There is no requirement to update their software to the state where they are adjusting. Therefore, as an example, an adjuster from Arkansas is basing costs and rates in New Jersey or New York with costs and rates from Arkansas, which would be radically different.
- There is no consideration by adjusters in the aftermath of a disaster for the demands on labor and scarcity of material, which drives up labor and material costs.
- Adjusters and adjusting firms are hired by insurance companies and are incentivized to produce low claim payouts. This puts the adjuster in direct opposition to the rights and well-being of the insured.

<sup>1</sup> Insurance Information Institute

## **RECOMMENDATIONS – THE ADJUSTERS:**

- Adjusters should be required to provide proof to the insured, by having the printout of the claim being adjusted delivered to both the insurer and the insured, demonstrating that the software and databases used are up to date and calibrated to the state where the claim is being adjusted. This would prevent wide variances in claims and limit disputes.
- In cases resulting from disasters, when it is known that labor and materials are likely to become scarce and therefore more expensive during recovery, there should be an agreed percentage allocated to adjust claims to accommodate the higher prices.
- Adjusters should be certified and engaged through FEMA to reduce incidents of collusion between adjusters and WYO insurance companies, such as revealed through United States District Court case 14MC 41 and 14 CV 461 when Wright National Flood Insurance Co., conspired to alter claims adjusting reports.

OF NOTE: A convergence of events that led to more disastrous events and negative sentiments toward NFIP and FEMA.

After Hurricane Katrina, by adjusting claims at a lower value and not taking into consideration the demands on labor and materials creating scarcity of both, homeowners were subjected to contractors providing what is referred to as Chinese Drywall. While the Chinese Drywall was less expensive and met the adjuster rates for sheetrock, it was not manufactured to United States standards. Chinese Drywall has since become the subject of many lawsuits and actions as it was discovered to be corrosive enough to cause additional damage to the home and the electric wiring, as well as being the source of serious respiratory problems. These issues in turn caused delays and additional claims.

The overall purpose of NFIP was to provide coverage, minimize the claims process and expedite getting flood victim's lives back to normal and returned to their home as soon as possible. The negative outcomes from these events caused insured's to lose trust for the insurance companies and negative sentiments toward NFIP and FEMA.

## **CHALLENGES – CONFUSING PROPERTY OWNERS:**

The NFIP policy is confusing and should be updated along with training and orientation material to remove the confusion. Brokers are not well versed in the policy nuances and property owners are lulled into misunderstandings and a false sense of security regarding coverage.

Currently, the NFIP policy provides replacement coverage for the dwelling/building, but only provides coverage on an actual cash value basis (depreciation) for contents coverage. This is markedly different from industry standard homeowner's policies where replacement cost for contents is covered. It is easy to understand where a standard industry practice would be assumed to translate as the same standard in a flood policy, especially when the flood policy is sold by the same company selling the insured their homeowners coverage.

Resolution options for a disputed claim are also unclear as to what an insured's options and rights are to dispute or challenge a claim, and what they can expect should they disagree with an insurance company's findings.

Another area of confusion is the lack of clarification that the insurance being offered, although under the name of the insurance company, is in fact the NFIP insurance policy.

## **RECOMMENDATIONS – CONFUSING PROPERTY OWNERS:**

- Special NFIP FEMA training classes for selling and administering flood policies should be created and required. To demonstrate understanding of the NFIP insurance policies these certification courses should be instituted along with a certification process before an agent or broker can sell a NFIP policy. The objective is to improve and ensure a professional standard of care. This same education standard should also apply to any adjuster employed or contracted to adjust flood related claims.
- More than adequate data regarding homeowner's experience is now available to better understand the property owner's misunderstandings as to the policy's coverage, which should be the basis for informational and educational material for property owners before they buy flood insurance.

- It should be required that a broker and/or agent review this material and obtain a signature from the property owner before writing the policy.
- This material should include an Insured's Bill of Rights along with contact information for both criminal and civil complaint filings.
- A review and adjustment of the NFIP policy to be in alignment with homeowner's insurance policy standards to eliminate misunderstandings.
- WYO Policy documentation to property owners to clearly and boldly state THIS IS A NFIP INSURANCE POLICY

### **POLICY AND PROGRAM RECOMMENDATIONS:**

Why not consider downsizing, and over time, eliminating the NFIP program?

A gradual migration of opening the market to competition and allowing free market conditions for flood insurance could limit the burden on the Federal Government.

- The current NFIP flood policy has limitations for below grade coverage (basements) and above grade coverage. This limitation should be removed and replaced with a more comprehensive policy.
- The more comprehensive flood policies could be offered at a higher premium, thereby giving FEMA the opportunity to once again become self-sufficient, which was the original intent of the 1968 Act.
- A 2-1 Policy Program: FEMA could require insurance companies to write two non-FEMA backed policies for every policy that FEMA backs.
- The rules would have to include that the non-FEMA policies be in the same zip code or flood plan code so as not to allow the insurance company to give the riskier policies to FEMA while retaining the lower risk policies.

Florida enacted a law in June of 2014 directing insurance companies to offer standard flood insurance policies similar to NFIP policies, and the ability and authority to offer more comprehensive flood policies. The insurance companies are allowed until October 1, 2019 to set rates without regulatory approval with the intention of spurring program growth. After October 2019, rate adjustments will come under regulatory approval.

By encouraging insurance companies to offer flood insurance within their policies and with an option for a replacement cost value structure, the risk associated with flood coverage is minimized by spreading that risk among all homeowner's policies. The basis of insurance is spreading the risk. This also enables property owners to buy a single policy that includes coverage for the peril of flood, making it far less confusing and less expensive insofar as a flood loss and/or a wind loss would not have to be proven as to who pays the claim as it would come under one policy. Insurance companies have been operating under this model for automobile insurance as it has always provided flood coverage under the comprehensive portion of the policy and automobile insurers, which are property and casualty insurers just like homeowners coverage insurers, and have not had a problem dealing with this type of loss.

### **CHALLENGES - INSURANCE COMPANIES VS POLICY HOLDERS:**

Like any program, it starts with good intentions, usually out of a pressured need, and then evolves as the strengths and weaknesses of the program design are revealed.

The insurance companies receive an expense allowance for policies written and claims processed while the federal government retains all responsibility for underwriting losses and expenses, including adjusters and lawyers from lawsuits filed against the insurance company. As all expenses are borne by the federal government, insurance companies have no need or incentive to pay or settle any claim.

Since the funds for flood claims are a pass through from FEMA to the insured, insurance companies had no incentive to control or regulate the validity of claims. They simply rubber-stamped and passed through claims. Post Hurricane Katrina, FEMA investigated and found a widespread practice of inflated claims. Insurance companies were lax in their requirements for documentation, both of the actual losses and the rebuilding costs. They simply administered the paperwork and paid the claims. This behavior on the part of insurance companies was borne from the fee-based arrangement between FEMA and insurance companies.

As one might expect, FEMA responded by implementing stricter controls for claim submissions and payouts. The program was changed and FEMA now penalizes insurance companies for overpayment. The penalties range from loss of the ability to participate in the WYO program, to the exposure of the insurance company being required to reimburse FEMA for any overpayment out of company funds. However, FEMA did not

investigate or require the same level of oversight when an insurance company did not pay a claim or paid considerably less than the value of the loss. It is in these instances that law suits arise and the costs to FEMA are now greater than the claims. FEMA offers no penalties for underpaying or denying claims. This imbalance drives insurance companies to push for, if not fraudulently orchestrate, undervalued claims and claim denials. The cost of disputes arising from these underpayments is borne by FEMA and not the insurance companies, thereby removing any risk for deliberate underpayments or claim denials.

What FEMA experienced post Katrina was a strain on their finances as a result of inflated, even fraudulent claims. With the change in direction and a new focus on challenging and penalizing inflated claims and curtailing payouts, insurance companies resorted to a different approach post Hurricane Sandy. Insurance companies are now motivated to pay out less on claims or deny them all together, which spurred a series of tactics, in of themselves fraudulent, to justify non-payment or reduced value, in an effort to satisfy FEMA and NFIP, and avoid any penalties.

FEMA was aware that there would now be the potential for an increase in insureds challenging claims as result of stricter controls over claims. To address this concern, the State of New Jersey required insurance companies in New Jersey to pay the full cost of arbitration, believing that it would create the necessary incentive for insurance companies to be fair in their claim adjustments. While the act was intended to help protect property owners, the result was far more costly. Insurance companies unwilling to bear the cost of arbitration were now motivated to forgo arbitration, even though the insured had the guaranteed right to arbitration at no cost to them, and forced policyholders into the drawn out and expensive process of litigation. And any claims or penalties levied would be passed on to FEMA. Few insureds were made aware of this no cost arbitration right unless someone directly informed them. While insurance companies were obligated to inform their insureds about this right, the information was buried and not highlighted, banking on the likelihood that an insured would not discover this option.

Additional pressure was put upon policyholders to meet deadlines dictated in statutes that determine the time allowed for a lawsuit to be filed. To avoid the expiration of that right, the statute should be extended; otherwise, the existence of the right to arbitration becomes meaningless. A possible solution to this problem could be to enact a kind of pause that once arbitration has been filed, the clock stops ticking on the deadline to file a lawsuit until 90 days after the arbitration decision and any appeals of that decision.

With the change to how insurers are incentivized, including paying the full cost of arbitration, post Sandy insured's were forced to turn to legal action in order to be fairly paid on their claims. This new wave of cases was so pervasive, as the deadline to file for lawsuits loomed closer, the American Bar Association published in their Spring 2014 Newsletter, the following update:

*Although the exact number is unclear, we anticipate thousands of federal lawsuits in the New York and New Jersey metropolitan areas. A "race to the courthouse" has already begun. Many lawsuits could have been avoided. There are many contributing factors that have led to litigation.*

*Most lawsuits are the result of the insurers' ultimate lack of accountability to policyholders, and arbitrary requests for additional documentation and unreasonable delay in making fair payment for property that often everyone agrees was damaged by floodwaters.*

*Other factors include cases in which the insurer has excluded structural/foundation damage as "preexisting" or "earth movement" or deemed the first floor as an excluded "basement" in the first six months after the storm.*

*A recent NFIP bulletin interprets the "appraisal" clause in a manner that appears to have deterred what may have been an effective method of alternative dispute resolution. The fact that WYOs routinely request that FEMA indemnify their legal fees further displaces their accountability and drives up costs on the NFIP and Treasury for cases that proceed to a lawsuit.*

As predicted, insurance companies routinely employed tactics that necessitated insureds to file lawsuits in hopes of being paid on their claims. Through these trials, activities were revealed that could be considered nothing less than fraudulent acts. As demonstrated in the United States District Court case 14MC 41 and 14 CV 461 (JFB) (SIL) (GRB), Judge Gary R. Brown determined that the defendant, Wright National Flood Insurance Co., conspired to alter claims adjusting reports so as to deny the plaintiffs, Deborah Raimey and Larry Raisfeld, an accurate and fair payment of their claim. Testimony was offered that exposed that the insurance company had the adjusters report rewritten to support their position to deny the claim.

While the plaintiffs may have won in this case, they were not made "whole." The plaintiffs had to hire an attorney along with other experts to support their case and proceed to trial.

- Case preparation and the cost of experts are borne by the plaintiff, typically out of the award.
- Lawyers fees are most commonly paid as a percentage of the award – as much as 1/3 of the value of the award.
- Plaintiffs are not compensated for these and other expenses such as, but not limited to:
  - Cost of monies required to act quickly for alternative housing, replacement and repairs prior to delayed awards, such as interest on loans or lost earnings from accessing assets that would

otherwise be earning.

- Lost time from work or diversion from operating a business.
- Lost time from family life.
- Additional life style adjustments to compensate for delays.

## **RECOMMENDATIONS - INSURANCE COMPANIES VS POLICY HOLDERS:**

As it is the actions of the insurance companies and to fairly treat the winning plaintiffs, the insurance company in a legal case where the insurance company is proven at fault, they should be required to pay all costs incurred by the plaintiffs, without exception. To fairly adjust wrong doings or fraudulent acts of the insurance company resulting in intentional under payments, such as willful denial of access to documents, and other acts of bad faith, plaintiffs should receive an additional amount to compensate for losses.

The financial damages due the plaintiffs should be substantial enough to throw the risk assessment toward curbing abusive tactics by insurance companies. A profit driven company could be motivated to stop these bad faith and illegal acts by monetarily penalizing them and not allow these penalties to be passed on to FEMA. Bad faith business dealings and taking advantage of the insured at their weakest moment is something that should not be tolerated. Insurance companies need to be penalized for bad faith dealings in addition to any other penalties enacted.

Additionally, FEMA, in conjunction with state and federal agencies, should be coordinating immediate notification on all cases, such as the example above, to the FBI. The FBI's National Center for Disaster Fraud should be more actively engaged. The appearance that insurance companies are immune to prosecution for fraud and bear no risk of punitive actions for these and other illegal tactics would begin to foster a more positive perception of FEMA as well as curtail the financial burdens they now are subjected to. By bringing investigative attention on an offending company, this could help to dissuade future deplorable and fraudulent tactics employed by insurance companies. Insurance companies would find this double front to defend civil and criminal investigations far less palatable and could in fact curtail or reduce the use of such tactics.

## **CHALLENGES - THE LAW FIRMS:**

The clear winners in every case forced to litigate are the law firms. Lawyers and firms that specialize in personal injury advertise a new specialty touting their experience and successes dealing with FEMA, and winning settlements against the WYO companies and/or FEMA to pay under the NFIP.

Law firms typically engage such cases in exchange for a percentage of the claim, and should the matter go to court, reap additional benefits all to the detriment of the insured. The cost to sue skyrockets in preparation for a court case. Besides the number of lawyers involved in a lawsuit, additional legal time and other specialists are called in on hourly fee basis. The following is a list of some of the additional professional fees:

- Court filing fees
- Recorders and transcribers for multiple depositions
- Engineers
- Adjusters
- Insurance experts
- Contractors
- And possible others

As an expert being retained by law firms on behalf of insureds, I have been asked on more than one occasion to forgo any additional fees, as the insured has no more money to pursue the matter. In other words, the cost to sue can begin to outweigh the potential award leaving the insured with far less than the claim value and far less than the cost to repair and replace property from the flood damage. Equally at risk is falling short of what is needed to cover the cost of a lawsuit that should not have been necessary. As noted above, should a lawsuit be filed and the insured is the victor, penalties should be levied against the insurance companies that compensate the injured party for all costs.

## **RECOMMENDATIONS - THE LAW FIRMS:**

Forcing the insured into a time consuming and costly lawsuit is the anvil that insurance companies hold over insureds to deter them from challenging under valued or denied claims. Insurance companies know well that both time and money are on their side; while insureds have far fewer resources to sustain such a battle. This imbalance thwarts insured from exercising their rights and allows insurance companies to under pay or not pay claims with immunity.

- Insureds should have the right to receive all documentation upon request in a timely fashion that is relevant to their policy and their claim without the need to engage a lawyer. By having this documentation, the insured can review for accuracy, and for any disputes bring them to arbitration.
  - If this material is not forthcoming upon request, altered or omitted, then there should be a strong penalty levied against the insurer for lack of cooperation and fair dealings.
  - I would go so far as to recommend that violating these requests or omitting documentation should be reported to the state's Department of Insurance and the FBI's National Center for Disaster Fraud Division.
  - Threats of investigation and sanctions are strong motivators for companies to conduct their business with fairness and in compliance with a standard of care.
- Insureds should have the right to engage the help of anyone of their choosing (CPA's, retired insurance producers, parents, friends, and insurance producers from other states) to serve as a proxy.
  - By allowing the insured to enlist help, it may take some of the emotion out of the debate on the value of the claim.
  - Insurance companies have salaried employees to deal with the insured. The insured has to take costly time away from work or dealing with the losses from the disaster in order to deal with the insurance company. By not having the right to a proxy, this becomes a practice that favors the insurance company.

# CONCLUSION

We should not lose sight of the purpose of the NFIP Act, which is to help with natural disasters causing flooding with coverage and claims. This is a taxpayer-funded program and it is the taxpayer who files the claim. However, all too often it is the taxpayer who suffers as a result of the system and is either underpaid or not paid at all. The taxpayer loses and the results can be further burdens on state and federal systems along with the damage of loss of trust in the system, the government, the courts and the insurance companies.

## **SUMMARY OF RECOMMENDATIONS FOR AN IMPROVED NFIP PROGRAM:**

1. Adjusters should be required to provide proof to both the insurer and the insured demonstrating that the software and databases used are up to date and calibrated to the state where the claim is being adjusted. This would prevent wide variances in claims and limit disputes.
2. In cases of disasters, when it is known that labor and materials are likely to become scarce and therefore more expensive during recovery, there should be an agreed percentage allocated to adjust claims to accommodate the higher prices.
3. Adjusters should be certified and engaged through FEMA to reduce incidents of collusion between adjusters and WYO insurance companies.
4. Special NFIP FEMA training classes for selling and administering flood policies should be created and required. To demonstrate understanding of the NFIP insurance policies these courses should be instituted along with a certification process before an agent or broker can sell a NFIP policy. The objective is to improve and ensure a professional standard of care. This same education standard should also apply to any adjuster employed or contracted to adjust flood related claims.
5. More than adequate data regarding homeowner's experience is now available to better understand the property owner's misunderstandings as to the policy's coverage, which should be the basis for informational and educational material for property owners before they buy flood insurance.
  - a. It should be required that a broker or agent review this material and obtain a signature before writing the policy.
  - b. This material should include an Insured's Bill of Rights along with contact information for both criminal and civil complaint filings.

6. A review and adjustment of the NFIP policy to be in alignment with homeowner's insurance policy standards to eliminate misunderstandings.
7. A 2-1 Policy Program: FEMA could require insurance companies that for every policy that FEMA backs, the writing company has to write two non-FEMA backed policies.
  - a. The rules would have to include that the non-FEMA policies are in the same zip code or flood plan code so as not to allow the insurance company to give the riskier policies to FEMA while retaining the lower risk policies.
8. The current NFIP flood policy has limitations for below grade coverage (basements) and above grade coverage. This limitation should be removed and replaced with a more comprehensive policy.
  - a. The more comprehensive flood policies could be offered at a higher premium thereby giving FEMA the opportunity to once again become self-sufficient, which was the original intent of the 1968 Act.
9. Insurance companies should be required to pay all costs and fees incurred by the insured including a value of the time the insured spent on the matter in addition to an amount for bad faith dealings and these should not be allowed to be passed on to FEMA.
10. Allowing the insured to be assisted by anyone of the insured's choosing to serve as a proxy in assisting them with the claims process.
11. Stopping the time clock to file a lawsuit once arbitration is filed to allow the complete arbitration process to be concluded, and preserving the option to file in court should the arbitration not occur or fail.

## **AUTHORSHIP**

This report is presented by Mr. Wayne Citron of CMC Advisors. Mr. Citron is an expert in forensic reconstruction of insurance transactions and specializes in policy interpretation of the rules, laws and regulations governing insurance and financial matters. Mr. Citron has been licensed for 43 years as a life, health and property and casualty insurance agent, broker and consultant.