
Testimony Before:

Subcommittee on Housing and Community Opportunity,
Committee on Financial Services,
U.S. House of Representatives

**MARYLAND'S EXPERIENCE
WITH THE NATIONAL FLOOD
INSURANCE PROGRAM**

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STATEMENT OF

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Congressional Testimony

Thank you Chairman Ney and other Sub-Committee members for the opportunity to testify before you today on behalf of the citizens of the State of Maryland with respect to their experiences with the National Flood Insurance Program, also known as the NFIP, following Hurricane Isabel.

On September 18 and 19, 2003 Hurricane Isabel impacted numerous states along the East Coast, including Maryland. The devastating effect Isabel had on property along the Chesapeake Bay was unprecedented. The Maryland Insurance Administration spent the weeks and months following the hurricane assisting storm victims all over the State informing them of their rights and coverages under their insurance policies and answering their claims questions. I think it is important to first point out that 18 months after Isabel we still have a number of Marylanders displaced and living in FEMA trailers who are not satisfied with the settlements they have received from the National Flood Insurance Program.

Through its outreach efforts, the Administration had the unique opportunity to hear first hand the frustration of those consumers whose attempts to rebuild were made even more difficult by the challenges of dealing with their insurance companies and the National Flood Insurance Program. The Administration attempted to assist Marylanders to understand their flood policies and tried to facilitate discussion between the consumers and the NFIP.

Under the direction of Governor Robert L. Ehrlich, Jr., the Administration worked with other state agencies to pool resources together to serve the citizens of Maryland. As a result, as of April 5, 2005 the Administration had processed 1,418 intake files and 508 formal complaints relating to Isabel. Of that total, 636 intakes and 137 complaints were directly related to the National Flood Insurance Program. In those 137 complaints, the individuals were able to obtain almost one million dollars in additional payment for their claims. While I do not have an actual dollar amount, I can tell you that additional payments totaling hundreds of thousands, if not millions, were made on many of the 636 intakes in which we assisted.

In an attempt to address many of the concerns that consumers had with the flood program, a number of federal, state and local officials, including myself, brought those concerns to the attention of the Federal Insurance Administrator. As a result, the NFIP agreed to reevaluate the flood claims to determine whether additional payments should be made. While the reevaluations did assist some citizens, its implementation was problematic and some insureds still have not recovered what they believe they are entitled to under the policy. A number of Marylanders had no choice other than to seek legal recourse to attempt to obtain the coverage they believe they are entitled to under their flood policy.

In response to continued widespread complaints of low or insufficient claim settlements, the Administration conducted an additional review into the process by which claims submitted to the NFIP were handled. Although the Administration does not have jurisdiction over the Federal Government's flood program, it decided, nevertheless, to conduct a review of the program to determine if there were areas where the program could be improved for the consumers who utilize it. During this review, the Administration interviewed various Write Your Own ("WYO") carriers, contractors, flood program claims adjusters and software companies that provide flood claims adjusting software.

In addition, I have met with Steve Kanstoroom, who has been an advocate for consumers not only in Maryland but across the country. Mr. Kanstoroom has been investigating FEMA related issues for the past year. He has spent a great deal of time meeting with consumers and others gathering data and compiling information related to the problems which individuals have had in settling their flood claims. Mr. Kanstoroom's experience in pattern recognition and fraud detection has allowed him to review this material with a degree of expertise, which has been extremely helpful in determining what problems exist with the flood program.

The Administration's investigation found a number of areas within the Flood Program that need review. These are specifically detailed in the *2005 Report of the Maryland Insurance Administration on the Experience of Maryland Citizens with the National Flood Insurance Program in the Aftermath of Hurricane Isabel*.

In the invitation to testify before this Committee, you asked me to address four key areas of concern. Given the limited time available today, it is difficult to fully address those issues; however, the Administration's 2005 Report, of which you have been provided copies, does address each of these concerns in great detail. I will just take a few minutes to give you a brief overview of the problems that we found to be most prevalent and of primary concern. I will conclude my testimony with my recommendations for changes to the Program.

PROBLEMS

1. Delay in assistance and lack of trained agents and adjusters that could provide accurate information.

The first problem consumers encountered occurred when they attempted to report their loss. Although they were told to first report the loss to their agent or insurer, many individuals found that their agents were unfamiliar with the flood program and were unable to advise them how to process their claim. Also, although the NFIP manual states that critical losses were to be inspected within 48

hours of receiving notice of the loss and others within one week, many individuals reported that weeks passed without receiving any contact from an adjuster. While the size of this disaster to some degree contributed to this problem, it appears that there is a shortage of experienced adjusters able to handle the claims.

The lack of an official claims process and manner to appeal the amount of payment was also apparent. Neighbors who had different adjusters were provided conflicting information, which was even more problematic due to the lack of any written claim procedures. Many individuals felt that their adjusters were making it up as they went along. The inconsistencies became more apparent once the re-review process started.

In many instances, consumers, for the first time, learned what was actually covered in their policy. Many had not been offered contents coverage and a large number found that their policies had been improperly rated and would not be entitled to receive payment for their claim until additional premium was paid. It became clear that the agents not only were unprepared for the role they were to play in facilitating the payment of the claims, but also had contributed to the delays and misfortune experienced by their clients. To combat this problem, the Maryland General Assembly, at the request of the Administration, enacted legislation requiring specific flood insurance continuing education for all agents who sell flood insurance every license renewal cycle. The Administration has worked collaboratively with producer groups to make certain that these courses were offered to agents on a regular basis.

2. Lack of uniformity in claims estimates and confusion over the use of pricing guidelines.

The Administration also discovered that some claims adjusters did not fully understand what the standard flood insurance policy covered, how to use the Pricing Guide provided by the NFIP vendor and how to process claims in a timely manner. There were questions raised in the immediate aftermath of the storm regarding whether the policy provided coverage for oil tanks located on the outside of the dwellings, the removal of contaminated soil under the dwellings, and mold and mildew remediation, to name just a few concerns. In certain instances, the NFIP itself reversed its position on coverage, and often, information on those coverage reversals was slow to reach the adjusters. This caused confusion among the insureds, some of whom received the new and correct information from their adjusters, while others were provided the prior, mistaken coverage decisions.

In a similar fashion, some adjusters, armed with the NFIP Pricing Guide, insisted that the only amounts payable for a sheet of plywood, drywall or other construction materials were those contained in the Guide. When demand for those materials rose, and the supplies on hand in local stores were depleted, the laws of

economics set in, causing prices to increase. Adherence to the Pricing Guide by adjusters caused shortfalls in the settlements to the insureds, even after evidence of the cost increases and the unavailability of materials at the estimated prices was repeatedly furnished. Finally, on May 7, 2004, nearly eight months after the storm, FEMA issued a Bulletin which indicated that the "Pricing Guide" was to be used with "discretion and flexibility"; however, by this time, many of the re-reviews had already taken place, and as a result, it was too late to avoid the frustration, confusion and anger of the claimants.

We have also heard allegations that victims were told: a) their replacement cost (RCV) policies are subject to depreciation; b) they are not entitled to sales tax; c) the policy only pays for items directly contacted by flood waters, and d) the NFIP is free to use new construction prices in lieu of more costly repair and renovation prices. As a result, Maryland has been left with many families unable to rebuild their homes and lives after receiving pennies on the dollar for their flood claims.

3. Due to lender requirements consumers are insured for amounts that they will never be able to obtain under the flood policies.

This issue may be the most problematic for many flood insurance policyholders. Prior to the settlement on the property, many insureds were advised by their lenders of the dollar amount of coverage, or limit, that must be purchased to secure financing and proceed to closing. As is often the case with waterfront properties, there is a great deal of value in the land itself, which is not covered under the flood insurance policy. When a loan is secured by both the land and the dwelling, the loan amount can, and very well may, be in excess of the replacement cost of the dwelling.

Most lenders advise that the limit of insurance must equal the amount of the loan; however, this will result in over insurance, especially if the value of the dwelling is not high. When a flooding event occurs, and the property is considered to be damaged beyond repair, the policy provides for the replacement cost of the dwelling. Unreasonable expectations follow; especially if the 1,000 square foot home was insured for \$200,000, and the settlement offered equals \$100,000. In accordance with the provisions of the policy, \$100,000 is the amount deemed necessary to replace the dwelling to its pre-loss condition. Many claimants found themselves in just this situation: paying a premium for coverage that they could never obtain, yet frustrated and angry because the amount being offered was deemed insufficient to rebuild, based upon the factors I previously highlighted. Inconsistent language, rules and guidelines in the NFIP/FEMA manuals and publications contribute to the over insurance problem and must be addressed.

4. Failure of the NFIP to implement the Program as Congress intended.

Although FEMA apparently disputes the legislative intent of the NFIP to restore claimants to their pre-flood condition, according to Senate Report 90-549 and House Report 90-786, "NFIP is a federal insurance program that provides flood insurance to over 4.4 million property owners across the United States. This program was established in 1968 to 'provide the necessary funds promptly to assure rehabilitation or restoration of damaged property to pre-flood status or to permit comparable investment elsewhere.'" Over the last eighteen months, the Maryland Insurance Administration has assisted hundreds of Marylanders who filed complaints stating that they received insufficient funds or inappropriate settlements in accordance with the terms of their flood insurance policies. In many cases, these allegations have been substantiated through the re-review process as additional sums have been paid to consumers. It appears that with respect to Hurricane Isabel claims, the intent of Congress was not met.

Conclusions and Recommendations

Many factors caused these problems with the Program: inadequate consumer education, inconsistencies in pricing guidelines and claims estimates, a shortage of trained adjusters, and a confusing and complicated bureaucracy that is difficult for the average consumer to navigate. The result is that consumers have been offered insufficient settlement amounts from the NFIP. For those Maryland citizens who are still displaced, the NFIP must take steps to review the claims again in an effort to ensure consistency and fair value in accordance with our recommendations. For future natural disasters, Congress should take the appropriate legislative action necessary to reform the NFIP by considering and implementing the recommendations contained in the Administration's 2005 Report, including those set forth below:

1. Concerns about the Administration of the NFIP, including understanding by consumers and agents.
 - Assure that there is full disclosure of the difference between contents and structural coverage by requiring the signature of the insured on the application or other documents that explain and waive contents coverage.
 - Provide to policyholders at time of sale, a Frequently Asked Questions ("FAQ") booklet or another easy to understand document that explains what is and what is not covered by the flood policy and how claims will be handled and paid under the policy. There should be a place on the document the purchaser signs where there is also a sign-off that the FAQ materials were given.

- Explain that a 30-day underwriting waiting period exists before the coverage becomes effective, unless the property is newly purchased and the policy must be procured in accordance with federal lending requirements.
- Assure that policyholders understand how the depreciation system works, i.e. that full replacement cost will not be paid until repair or rebuilding work is completed. This could cause a cash flow problem for the policyholder if damage is incurred.

2. Problems with the appeals process and adequacy of payment.

- Conduct a review of the policy provision that allows the insurance company to delay the settlement of a claim relating to the loss of contents pending the resolution of a claim relating to damage to the insured structure.
- Consider amending the portion of the policy which states that repair or rebuilding of damaged or lost property will be made with material of "like kind and quality or its functional equivalent" by deleting the "functional equivalent" statement. An example is a kitchen with granite countertops, which is valued by the appraiser for the value of Formica countertops. Both are functional equivalents, but while they may be "like kind," they are certainly not "like quality."
- Establish a time deadline for inspection of damage and for the settlement of claims.
- Require that, when a claim is made, companies immediately provide the claimant with a document that explains in clear and simple language the claims adjustment process, including how the claimant can challenge the decision of the original adjuster.
- Create a formal appeals process for policyholders. Tell policyholders *in all printed materials* that they are entitled to ask for a General Adjuster to review the insurance company's adjuster's decision. Currently there is NO formal appeals process for policyholders who do not agree with the decision of the insurance company adjuster. In fact, the NFIP policy itself has neither a telephone number to call nor address to write directly to NFIP for inquiries. Require contact information, including a telephone number and email address that policyholders can use if they have questions concerning coverage or the appeals process.
- Require that claim denial letters give clear and specific explanations of the basis for the denial and include instructions for contesting the denial.

- Eliminate the use of the Pricing Guidelines or alternatively the FCPRP must be clarified to indicate that the Pricing Guidelines are not used for auditing purposes. This change will allow adjusters more liberty to adjust the costs of materials to reflect increased prices that almost always occur after a flood event.
 - Require that people be told that even after they sign the proof of loss statement, they can reopen their claim if material and building costs increase. Policyholders can ask for a variance (with receipts for proof), even after construction has been completed, but many do not know this.
 - Require specific instructions that explain what a policyholder's appeals rights are, including what legal action can and cannot be taken against the WYO, FEMA, or NFIP. While FEMA may believe the National Flood Insurance Act made clear that Congress intended lawsuits only on a disallowance of a claim and that by creating the WYO program they did not intend to expand the areas in which policyholders could bring suit, insureds do not understand the narrow interpretation of sovereign immunity in these cases.
 - Additionally, FEMA should consider allowing states to have more regulatory oversight of the flood program with respect to the claim process.
3. Lack of coordination between private insurers, NFIP and FEMA.
- Develop a clear process or procedure for amending the terms of a policy if it is determined that the property is over insured.
 - Conduct an exhaustive review of the terms and conditions of the policy in light of the types of properties located in the flood zones, (i.e. those with oil tanks located on the outside of the dwelling) and the value of the properties and the coverage provided (i.e. no coverage for contents in basement or lowest level). The review should include an analysis of the items that are currently covered and excluded.
 - Correct the Lenders Manual and The Flood Insurance Manual to remove any inconsistencies in how to calculate replacement cost.
 - Develop a replacement cost estimator specifically designed for the coverage provided by the NFIP in conjunction with a company such as Marshall & Swift/Boeckh.
 - Require Write Your Own (WYO) companies to audit policies at the time they are purchased to make certain appropriate rating and classification criteria

(such as flood zone designation) have been applied and appropriate premium has been charged.

- Reassess the requirement that in order to get a Small Business Administration (SBA) loan, an NFIP policyholder who did not previously have contents coverage may be required to purchase a contents policy even if the structure is not currently inhabitable and there are no contents to insure at that point.
- Re-evaluate the training, certification and pay scale and methodology for flood adjusters. Consideration should be given to the role of adjusting firms and the costs associated therewith.
- Communication between NFIP and its contractor, CSC, needs to be improved to ensure that policy decisions regarding coverage are consistently implemented and adopted by CSC.
- Establish a uniform estimate/"proof of loss" format. Each software company indicated that incorporating a standard format, as prescribed by FEMA, could be easily accomplished. The format should include:
 - Uniform use of terms;
 - Indication of which prices were manually adjusted or overridden by the adjuster;
 - Override explanation: when a price is overridden, the software needs to provide a field for an explanation and it must be mandatory that the field be completed by the adjuster; and
 - Notation as to which pricing database was used at the time the claim was adjusted.

4. Adequacy of Agent Training

- Require that consumer education be provided by the producer at the inception of the policy, and Question and Answer documents, newsletters, etc. should be sent at renewal to the consumer. Flood damage mitigation and prevention tips should also be provided.
- All agents that sell flood insurance should be required, as they now are in Maryland, to take continuing education courses when they renew their license to sell insurance.

Congress should also consider any recommendations offered as a result of the pending GAO audit, and seek input from other insurance regulators and the Catastrophe Insurance Working Group of the National Association of Insurance Commissioners. Thank you for the opportunity to appear before you today and offer you my recommendations, which I firmly believe are necessary for the flood program to provide the type of assistance to citizens that Congress intended when the Program was created.