

The National Flood Insurance Program:  
Recent State Experiences with the NFIP

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Drafting Note

*This report is currently in draft form. It was drafted by NAIC staff at the request of the Flood Insurance Study Group of the Government Affairs (EX) Task Force. It has not been distributed for public comment. It is undergoing review at this time by the Flood Insurance Study Group and should not be released to the public until such time as so ordered by the chair of the study group.*

Background

The recent experiences of several states with regard to floods that occurred in 2003 and 2004 have prompted insurance regulators to take an interest in how well the National Flood Insurance Program (NFIP) is meeting the needs of Americans. At its meeting on March 14, 2005, the NAIC's Government Affairs (EX) Task Force appointed a Flood Insurance Study Group to evaluate the NFIP and make recommendations regarding needed improvements to the program so that consumers will be better served in the future. The purpose of this paper is to document findings of the Flood Insurance Study Group and to make recommendations for improvements that the study group believes are necessary to serve the public more efficiently and as Congress intended when it enacted the NFIP in 1968.

Recent Experiences of State Insurance Regulators with the NFIP

At the request of the Flood Insurance Study Group, NAIC staff undertook a survey of states to determine if states were having difficulties related to the marketing or delivery of flood insurance or involving claim settlement issues. Eleven jurisdictions responded to the survey request. Of the eleven jurisdictions responding, three reported no problems related to flood insurance and one reported that some issues were identified that were resolved by working with the NFIP's regional manager for the area. In fact, In April 2005 Maryland prepared a report that thoroughly described the experiences that Maryland residents had with the NFIP. The other seven jurisdictions reported a variety of problems with the NFIP. These issues are documented in this section of the report.

Among the problems identified were:

- Delays in responding to consumer inquiries and claims;
- Lack of adequately trained insurance producers that are familiar with the NFIP and able to provide accurate advice and information;
- Lack of adequately trained insurance adjusters that are familiar with the NFIP and able to provide accurate advice and information;
- Lack of understanding by consumers regarding limitations of flood insurance coverage, particularly how contents coverage is treated;
- Differences in adjusting the flood insurance part of a claim and the remaining property claim;
- Lack of coordination between flood and property adjusters;
- Lack of uniformity in claim estimation;
- Confusion over the use of Price Guidelines;
- Insufficient numbers of company claims adjusters to handle the volume of claims experienced;
- Lengthy delays and inadequate follow-up by adjusters after their initial visit;
- Poor customer service by NFIP and "write-your-own" companies, i.e. failure to return phone calls or follow-up with consumers;
- Inconvenience and confusion caused to consumers who were forced to deal with multiple adjusters (flood adjuster, homeowners adjuster, SBA adjuster, etc.);
- Conflicting information given to consumers by producers, adjusters, "write-your-own" carriers and the NFIP;
- Delays in re-inspections;
- Delays in claim settlement once an adjuster has referred the claim to the DC NFIP Office;

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- Inordinate amount of unlicensed Public Adjusters soliciting business;
- Misinformation on insurance-to-value requirements provided by lenders insisting that policyholders cover the amount of the loan rather than the replacement cost of the dwelling (i.e. the value of the land is required to be covered);
- Lack of an informal appeals process that allows a consumer to address grievances in ways other than going to federal court;
- FEMA does not appear to have implemented the NFIP in a manner consistent with the Congressional intent to restore claimants to their pre-flood condition.

A copy of the survey request and the state responses are included in the Appendix.

#### Implementation of Senate Bill 2238 of 2004

Congress enacted Senate Bill 2238 of 2004 (Public Law 108-264), also known as the “Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004.” This bill was signed into law on June 30, 2004. S 2238 reauthorized the NFIP for a five-year period. Included in the reauthorization was a \$40 million pilot program that will allow states and communities to participate in a mitigation effort that targets severe repetitive loss properties. Congress also made improvements to the NFIP so that it is better able to meet the Congressional intent of making claim settlements easier and more transparent and making access to information about the NFIP easier to obtain.

There are two important provisions contained in S 2238 that are designed to address concerns of insurance regulators. First is the provision in Section 207 that requires the Director of FEMA to cooperate with the insurance industry and insurance regulators to establish minimum training and education requirements for all insurance agents that sell flood insurance policies. The second important provision is contained in Section 205. It requires FEMA to develop a regulation that establishes an appeal process for policyholders that provides the policyholder an opportunity to appeal a claim decision, proof-of-loss or loss estimate by an insurance agent or adjuster or contractor of FEMA.

With regard to Section 207, FEMA representatives have been working with insurance regulators and insurers through the NAIC. FEMA has drafted, but not formally published, the regulation required in Section 207(2) and has held two informational web casts where insurance regulators were invited to participate with FEMA employees in exchanging information about the roles each will play in implementing Section 207’s requirements. The regulation remains in the review process at the time this was written.

To implement Section 207, FEMA plans to develop and distribute informational and educational materials that states and continuing education vendors can use to inform insurance producers about the NFIP and its products. FEMA has asked insurance regulators to assist in implementing the requirements of Section 207 by requiring insurance producers to meet basic pre-licensing and continuing education standards. At the time this was written, a meeting has been scheduled to work on details regarding responsibilities for tracking insurance producer compliance. Current state systems are in place that track the number of continuing education hours that an insurance producer has completed, however, systems do not generally track the specific course content, perhaps with the exception of ethics in some jurisdictions.

To date, FEMA has not published the regulation required under Section 205. Although the law requires that this process be established 6 months after the enactment of the law, it is unknown when this will occur. Generally the federal rulemaking process takes between six and nine months to complete. State insurance regulators have not been a part of this process.

S 2238 also contains a requirement that the Government Accountability Office (GAO) conduct a study of the NFIP. The study is intended to evaluate three major areas. First, the GAO is to look at the adequacy of the scope of coverage provided under flood insurance policies in meeting the intended goal that flood victims be restored to their pre-flood economic conditions. The GAO is also asked to evaluate the adequacy of payments to flood insurance victims. Finally, the practices of FEMA and flood insurance adjusters in estimating the value of losses and the adequacy of payments will be evaluated. The GAO report is due one year from the date of enactment.

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The NCOIL Model Law

On November 21, 2003, the National Conference of Insurance Legislators (NCOIL) adopted the State Flood Disaster Mitigation and Relief Model Act. The model law implements a multifaceted state program of insurance producer and realtor education; local floodplain zoning; mandatory purchase of flood insurance by, and notification by lenders to, property owners in a floodplain; property owner self-certification of compliance; and other measures to improve floodplain management and hazard mitigation.

The NCOIL model law has four parts. The first part requires the purchase of flood insurance through various means for properties located within floodplains. It also contains notice requirements for lenders related to flood insurance. The second part addresses floodplain management and use. Part three deals with floodplain management and hazard mitigation. The fourth part addresses miscellaneous provisions such as producer pre-licensing and continuing education requirements.

Part four of the NCOIL model contains requirements for resident insurance producers. Resident insurance producers must demonstrate satisfactory knowledge and understanding of flood insurance and the NFIP in order to qualify for a license. It also requires that insurance producers that already hold a resident license complete a continuing education course related to flood insurance and the NFIP within two years of the date that the law is enacted. The course must be state approved and at least three hours in length. Successful completion of the course entitles the producer to three hours of continuing education credit.

Part four also contains requirements related to insurance adjusters. It requires flood insurance training for both pre-licensing education and two hours of continuing education at least every two years.

The language from the pertinent sections of the NCOIL model law follows:

**Sec. 1. Insurance producer qualification; continuing education**

The *[State entity for regulating insurance]* shall require:

(1) *Pre-licensing requirement.* The *[State entity for regulating insurance]* shall require all resident insurance producer applicants to demonstrate satisfactory knowledge and understanding of flood insurance and the National Flood Insurance Program, as determined by the *[State entity for regulating insurance]* in order to qualify for licensure.

(2) *One-time continuing education requirement for existing licensees.* The *[State entity for regulating insurance]* shall require resident insurance producers licensed on *[the bill's effective date]* to complete a continuing education course related to flood insurance and the National Flood Insurance Program before *[a date certain at least two years from the bill's effective date]*. The course shall be three hours in length and shall be approved by the *[State entity for regulating insurance]*. Completion of the course will provide the licensee with three hours of continuing education credit.

**Sec. 2. Insurance adjuster qualification; education**

The *[State entity for regulating insurance]* shall require:

(1) Insurance-adjuster license applicants to demonstrate satisfactory knowledge and understanding of flood insurance, as determined by the *[State entity for regulating insurance]*, in order to qualify; and

(2) An applicant for an insurance-adjuster license renewal to complete at least two hours of continuing educational programs in flood insurance every two years.

Recommendations for Change

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The Flood Insurance Study Group has evaluated the recent experiences of the states responding to the survey, reviewed the provisions of S 2238 and the NCOIL model law and concludes that there are some areas that need improvement. There fore, the study group makes the following recommendations:

Education, Recruitment, and Training of Insurance Producers

The study group believes that there are not a sufficient number of trained and qualified adjusters to handle catastrophic losses. The group recommends that the pay scale for adjusters be reevaluated in order to make certain that qualified adjusters are available. The study group commends Congress for enacting Section 207 of S 2238. It recommends that state insurance regulators work closely with FEMA to effectively implement its provisions. The study group believes that three hours of either pre-licensing or continuing education specific to flood insurance and the NFIP would help to improve the dissemination of information and advice to insurance consumers. The study group recommends that states implement the provisions of Part Four, Section One of the NCOIL model law by having the state legislature adopt the model language into law, having the insurance regulator publish a regulation if the commissioner has the appropriate authority to do so, or having the requirements published in a bulletin if the commissioner has the appropriate authority to do so. The study group believes that enhanced insurance producer training will help reduce the lack of understanding by consumers regarding limitations of flood insurance coverage. The study group also believes that FEMA, real estate sales persons and financial institutions have a role to play in educating the public about the unique characteristics of flood insurance and the rules of the NFIP.

Education and Training of Insurance Adjusters

The study group believes that two hours of pre-licensing and two hours every other year of continuing education specific to flood insurance and the NFIP would be sufficient to improve the claim settlement process for insurance consumers. The study group recommends that states implement the provisions of Part Four, Section Two of the NCOIL model law by having the state legislature adopt the model language into law, having the insurance regulator publish a regulation if the commissioner has the appropriate authority to do so, or having the requirements published in a bulletin if the commissioner has the appropriate authority to do so. The study group believes that enhanced insurance adjuster training will help reduce the inconsistencies among claims adjusters and lead to more uniform and fair claim settlement offers.

Improving the Disclosure of Information to Policyholders

Many of the issues identified during this study relate to lack of understanding. This is particularly true for consumers. The public does not generally understand insurance products and when they do, it is natural for them to think that flood insurance and property insurance will be very similar. The first area of misunderstanding is that flood is a covered peril in the standard homeowners policy. Once this hurdle is overcome, consumers must learn that a flood insurance policy has some significant differences from what they are used to in a homeowner's policy.

The study group recommends that improved disclosures be made in the following areas:

- There is a general lack of understanding regarding the 30-day waiting period that exists in the NFIP. This is different from other property insurance coverage. This should be fully explained to the public.
- There is a general lack of understanding regarding the fact that contents coverage is an option in the flood insurance policy. This is different from other property insurance coverage where it is included and its limit of liability is determined by a factor applied to the property limit. This should be fully explained to the public.
- There is a general lack of understanding regarding some of the unique coverage limitations and exclusions that exist in the NFIP. For example, coverage for contents in basement is excluded. This is different from other property insurance coverage. This should be fully explained to the public.

The study group notes that Congress in S 2238, Section 202, has imposed additional requirements on FEMA to develop easy-to-read disclosure forms to be given to all policyholders at the time of issuance or renewal of a flood insurance policy. The

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study group encourages FEMA to work with state insurance regulators to develop disclosure documents that require a formal acknowledgement from the consumer that the disclosures are received. The disclosure document should describe, at a minimum, all of the items listed above. If the consumer has decided not to purchase the additional contents coverage, this too should be formally acknowledged. The disclosure form might be cast as a series of questions and answers about the NFIP. FEMA should also include information about the claims settlement provisions in the policy, particularly how the flood insurance product treats replacement coverage.

Addressing the Adequacy of Payment Issues

The study identified many issues related to consumer dissatisfaction with the amount recovered following a loss. While some of these issues occur in other property insurance losses, many are unique to the NFIP. One of the primary problems is the fact that the claim estimators that are used are not uniform and vary in their terms and formats. This problem can be eliminated by establishing a uniform estimate/"proof of loss" format. This format should include:

- a) uniform use of terms;
- b) indication of which prices were manually adjusted or overridden by the adjuster;
- c) 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
- d) notation as to which pricing database was used at the time the claim was adjusted.

In addition, it must be made clear to adjusters that pricing guidelines must be applied flexibly in order to reflect increased costs that occur as a result of a flood event. The NFIP needs to:

- a) correct the Lenders Manual and The Flood Insurance Manual to remove any inconsistencies in how to calculate replacement cost;
- b) develop a replacement cost estimator specifically designed for the coverage provided in the Flood Insurance Program in conjunction with a company such as Marshall & Swift/Boeckh;
- c) develop a clear process or procedure for amending the terms of a policy if it is determined that the property is over insured; and
- d) include a guideline for auditing coverage amounts to make certain that properties are adequately insured.

Finally, the study group notes that Congress in S 2238, Section 204, has imposed additional requirements on FEMA to develop a *Flood Insurance Claims Handbook*. The study group notes that after Hurricane Katrina, the NFIP released the handbook. Prior to its release, FEMA did not seek the input of state insurance regulators as to what should be included in this handbook. While the current handbook is a good start, the group believes the following information needs to be included:

- Since the NFIP is not subject to state consumer protection laws regarding timely payment of benefits, the handbook should contain specific deadlines for acknowledgement of a claim, inspection of the damage and final settlement of a loss. These deadlines should apply regardless of whether the policy is issued directly by FEMA or through the Write-Your-Own (WYO) program.
- The study group notes that the handbook should also include an explanation of the policy provision that allows an insurer to delay settlement of the contents portion of a claim pending resolution of the claim on the dwelling. The study group would prefer that FEMA rethink this policy provision as it is not consumer friendly and does not fit with the general purpose of the program or Congressional intent to restore the policyholder to pre-flood loss conditions as expeditiously as possible.
- If a claim is denied, the claimant should be provided a communication that clearly and concisely explains the basis for the denial and provides information about how one would contest the decision.

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- The handbook should provide information to clarify the use of the NFIP's Price Guidelines. Misunderstandings were observed related to whether the Price Guidelines were recommendations or absolute caps on claim settlement amounts. The Price Guidelines do not account for the demand surge that is often observed following catastrophe losses where prices of building materials rise in a hard-hit area because the demand for the building materials rises substantially. This condition should be noted and taken into consideration.

Addressing the Lack of an Appeal Process

Since the NFIP is a federal program, it is not subject to direct regulation from state insurance regulators. While state consumer protection laws provide specific timeliness requirements for claim settlements and offer a dissatisfied claimant a formal remedy to address grievances, the NFIP lacks such a mechanism. Insurance regulators have discovered that many times the only remedy available to aggrieved claimants is to take the issue to federal court. At times, the amount in dispute is not large enough to warrant the time and expense of doing so. While large differences of opinion can be adjudicated in the federal courts, smaller disputes simply leave the unhappy claimant with no place to turn.

Congress could address this problem in one of two ways. It could enact a statutory change that grants greater powers to state insurance regulators over the NFIP regarding claim settlements or it could establish a workable appeals process at the federal level. It appears that for now, Congress has selected the latter. S 2238 contains a provision in Section 205 that requires FEMA to develop a regulation that establishes an appeal process for policyholders that provides the policyholder an opportunity to appeal a claim decision, proof-of-loss or loss estimate by an insurance agent or adjuster or contractor of FEMA.

The study group notes that the Claims Handbook contains an appeal process; however, this process is very limited in that there are no details about the review process. The process was made public after Hurricane Katrina and, in fact, is the same process that was implemented after Hurricane Isabel, which was ineffective, at best. The study group encourages FEMA to work with state insurance regulators to develop a more detailed process that allows appeals to be conducted by electronic means, by telephone or in-person. Persons should not be required to travel long distances to participate in an appeal. Information should be provided about the authority of the adjudicator to settle the claim. Clear procedures should be developed to identify and communicate next steps if the informal process still leaves the person unsatisfied.

State Oversight of the Claims Process

In light of all the problems that the NFIP has encountered with the claims process and the vast experience that the States have had with homeowners' claims, Congress should carefully consider whether it is appropriate to give states oversight over the claims process.

Conclusion

The Flood Insurance Study Group concludes that there are many problems with the NFIP and has attempted to identify many of the more significant issues in this report. The study group believes that Congress is aware of many of these issues and has addressed most of them in S 2238. The study group observes that FEMA has missed several deadlines established in S 2238. This is a primary concern to this group in light of the fact that we are in the middle of hurricane season and the country has experienced numerous floods over the last few months. Notwithstanding, the Congressional directive to have mechanisms in place to help consumers during this season, it was not until after Hurricane Katrina that items such as the flood handbook and the appeal process were made public. It is still unclear whether the documents are being distributed to the policyholders that suffered losses as a result of Hurricane Katrina. As of this date, the NFIP has not sought the input of state regulators on the content of any of these consumer materials. It also appears that the NFIP has failed to acknowledge the problems with the program and has not been willing to listen to the recommendations for changes to the program. In order for this program to fully assist consumers, they must interact with State and local officials and include them in the process.

In addition to these consumer education elements, changes need to be made within the Program to the claims adjustment process, including better trained adjusters and consistent claims software to make certain that all consumers are treated fairly. The study group encourages FEMA to work with state insurance regulators to assure that the public is being well served by

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the NFIP. The study group believes that it is important for the NFIP to deliver on the promises that Congress made—namely that the NFIP is to “provide the necessary funds promptly to assure rehabilitation or restoration of damaged property to pre-flood status or to permit comparable investment elsewhere<sup>1</sup>.”

The study group also encourages the GAO to thoroughly study the NFIP and advise Congress regarding shortcomings that remain following the enactment of S 2238. The study group hopes that the GAO will contact state insurance regulators during its review of the program.

State insurance regulators have a long history grounded in consumer protection. Regulators stand ready to assist Congress, the GAO and FEMA in any way that they can to better serve the insurance buying public. Together we can help deliver on Congressional intent to properly and expeditiously indemnify American flood victims through the NFIP.

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<sup>1</sup> Senate Report 90-549 and House Report 90-786.