U.S. Senate Committee on Banking, Housing, and Urban Affairs

Majority Staff Report

Assessing and Improving Flood Insurance Management and Accountability in the Wake of Superstorm Sandy

22nd June 2015

BIG/IR-2015-01

Table of Contents

Executive Summary

Background

The most destructive storm of the 2012 Atlantic hurricane season, Superstorm Sandy smashed ashore on the U.S. East Coast in October 2012 after cutting a path of destruction north from the Caribbean. Altogether, it has been estimated to have caused more than $68 billion in damage, and killed over 200 people in several countries. The second-costliest such storm in U.S. history – behind only Hurricane Katrina in 2005 – Sandy is reported to have killed at least 117 people in the United States alone, and it caused tremendous damage along the most populated coastline in the country. As a result, Sandy generated 144,484 claims under federal flood insurance coverage under the National Flood Insurance Program (NFIP).

This Banking Investigative Group review was undertaken in light of concerns that structural flaws in the NFIP had led or contributed to underpaying flood insurance claims in the wake of Superstorm Sandy. This review has not attempted to examine any specific flood claims or cases presently in litigation, but aims to provide a programmatic overview of the NFIP claims process in order to help Congress assess the adequacy of the program's structure and function in light of Sandy-related challenges.

This Report begins by laying out how the NFIP claims management process works, how its various pieces interact, and how the Federal Emergency Management Agency (FEMA) attempts to ensure quality control. It then explores the incentive structures that face insurance companies, claims processing vendors, adjusters, and engineers, and the management challenges that confront the NFIP as it attempts to handle catastrophic flood events.

Overview of Findings

Despite widespread concerns, it does not appear that systematic incentives exist for any participant in the program to underpay on claims. Nor does there presently exist evidence of any such pattern of underpayment. Theories of "systematic underpayment" are inconsistent with the actual data produced by FEMA auditing. We found no persuasive evidence to support the existence either of any general incentive to underpay policyholders or of any practice of doing so. Data from claims operation reviews of "Write-Your-Own" (WYO) insurance carriers – private companies that issue and service NFIP policies – and from the "Direct" program, in fact, show low overall rates of payment errors. If anything, these data indicate that overpayments are more common than underpayments.

Other audit data also contradict "pattern of underpayment" concerns. First, FEMA's Claims Reinspection Program (CRP) audit of Sandy-related claims in 2013 shows a low overall error rate, as well as a predominance of overpayments. Second, FEMA's reporting under the Improper Payments Information Act (IPIA) and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) shows low overall error rates. These data broadly corroborate a conclusion of low overall error rates and a general predominance of overpayments.

An analysis of participant financial incentives also fails to support any conclusion about systematic underpayment. WYO participants in the NFIP make more money as the total amount of claims paid out to their policyholders increases, giving WYOs a financial stake in maximizing claims paid. Furthermore, the adjusters who estimate flood damage in the field – as well as the adjuster companies whose staff examiners review field reporting – also have an incentive to maximize claim values, because they are paid pursuant to an NFIP Fee Schedule that pays them more on higher-value claims than on smaller ones. While we cannot discount the possibility that certain adjusters performed subpar assessments of some Sandy claims or even engaged in outright fraud, we found no evidence to support the theory that adjusters have a systematic incentive to downplay flood damage.

We also found no evidence to support the hypothesis that engineers who come to the NFIP during a flood crisis have an incentive systematically to downplay flood damage. While we cannot discount the possibility that certain engineers committed misconduct in connection with some Sandy claims or even engaged in outright fraud, we found no evidence to support the theory that engineers have a systematic incentive to downplay flood damage.

It is also important to note that the Direct side of the NFIP – where there are no WYOs, and FEMA oversees flood claims management more directly – exhibits the same pattern of claims problems as the WYO side, including the same "pickup rate" at which claims cases have resulted in Sandy-related litigation. (If anything, FEMA reinspection data suggest that the Direct side of the program underpaid on Sandy claims at a higher rate than did the WYOs: the Direct side handled less than 12 percent of Sandy claims, but made nearly 30 percent of the Sandy underpayments discovered by such reinspection.) The fact that similar claims difficulties developed on both sides of the NFIP indicates that structural WYO program incentives were not a cause of whatever problems may have occurred.

Moreover, even if WYOs participating in the program did perceive an incentive systematically to underpay flood claims, there does not appear to be a clear or reliable way in which they could direct outcomes in the field in order to implement such a strategy. The attenuated control system through which NFIP claims are managed would make implementing any such strategy extraordinarily difficult.

In offering a "net assessment" of the overall structure and operation of the NFIP, therefore, this review finds that the available information does not support the hypothesis that financial incentives both encourage and have resulted in a general pattern of underpayment on flood insurance claims. Theories of systematic underpayment based upon WYO or adjuster fears of having to repay overpayments are inconsistent with available data. (If anything, it is probably possible for a WYO to make more money by systematically overpaying on NFIP claims, though we do not draw this conclusion.) All in all, the most plausible explanation for difficulties in Sandy claims management is simply that the complex nature of the standard flood policy combined with the scale of Sandy overwhelmed the NFIP's supply of adjusters and engineers, inevitably resulting in problems.

Our finding that there does not appear to have been a systematic error bias or any general "pattern of underpayment" across the NFIP, of course, does not mean that there have been no

underpayments. As with any catastrophic event, errors are to be expected, and with 144,484 Sandy claims having been made, it would be surprising if no errors had occurred. Moreover, even a low error rate in the processing of Sandy claims would likely equate to a considerable number of policyholders who were underpaid.

Managing the NFIP is a considerable challenge. On both the WYO and the Direct sides of the program, claims management involves complex chains of contractors and vendors which make detailed control by FEMA or the WYOs difficult. The program is highly, and explicitly, reliant upon the independent judgment of field personnel. Given this reliance it is essential that the NFIP have strong processes for identifying payment errors, allowing policyholders to make claims for supplemental payment, and appealing denials of coverage.

There is much room for improvement. FEMA's internal appeals process, for example, is one in which FEMA refuses to order that appropriate payments be made even when it agrees with a policyholder on appeal. FEMA, moreover, does nothing to track actual appeal outcomes. FEMA has now adopted a special, separate mandatory process for Sandy claims. While FEMA attempts to re-evaluate Sandy claims, this new process effectively discriminates against non-Sandy flood victims in areas such as Kentucky, Texas, and elsewhere – who remain subject to FEMA's flawed and merely hortatory appeals procedures.

Recommendations

This Report does not address specific allegations of fraud in any particular Sandy cases, but it does conclude that important improvements are both possible and necessary in how the NFIP handles claims cases – especially in the wake of a major flood event. Among these:

- Training for adjusters and engineers needs to be systematized and improved, and FEMA should do more to ensure effective tracking and after-the-fact accountability for such experts in the event of incompetence or fraud.

- FEMA should improve its pre-crisis contingency planning and preparation for the deployment of adjusters, engineers, and other expert services.

- FEMA should improve its process for on-the-spot error-correction and trend-spotting in the field after major events, and institutionalize some sort of "second-look" error-correction process.

- FEMA should be more willing to provide written guidance to NFIP participants in order to prevent divergent interpretations of NFIP rules and approaches.

- FEMA should endorse and institutionalize quality control reviews by expert adjusters and engineers in order to protect against errors in reports by field personnel, especially in the wake of major events that are likely to overwhelm available staffing resources.

- FEMA should institute a process whereby claims case appeals inside the agency result in mandatory payments when FEMA officials determine that the policyholder is correct. The current system of merely making recommendations to this effect is inadequate.

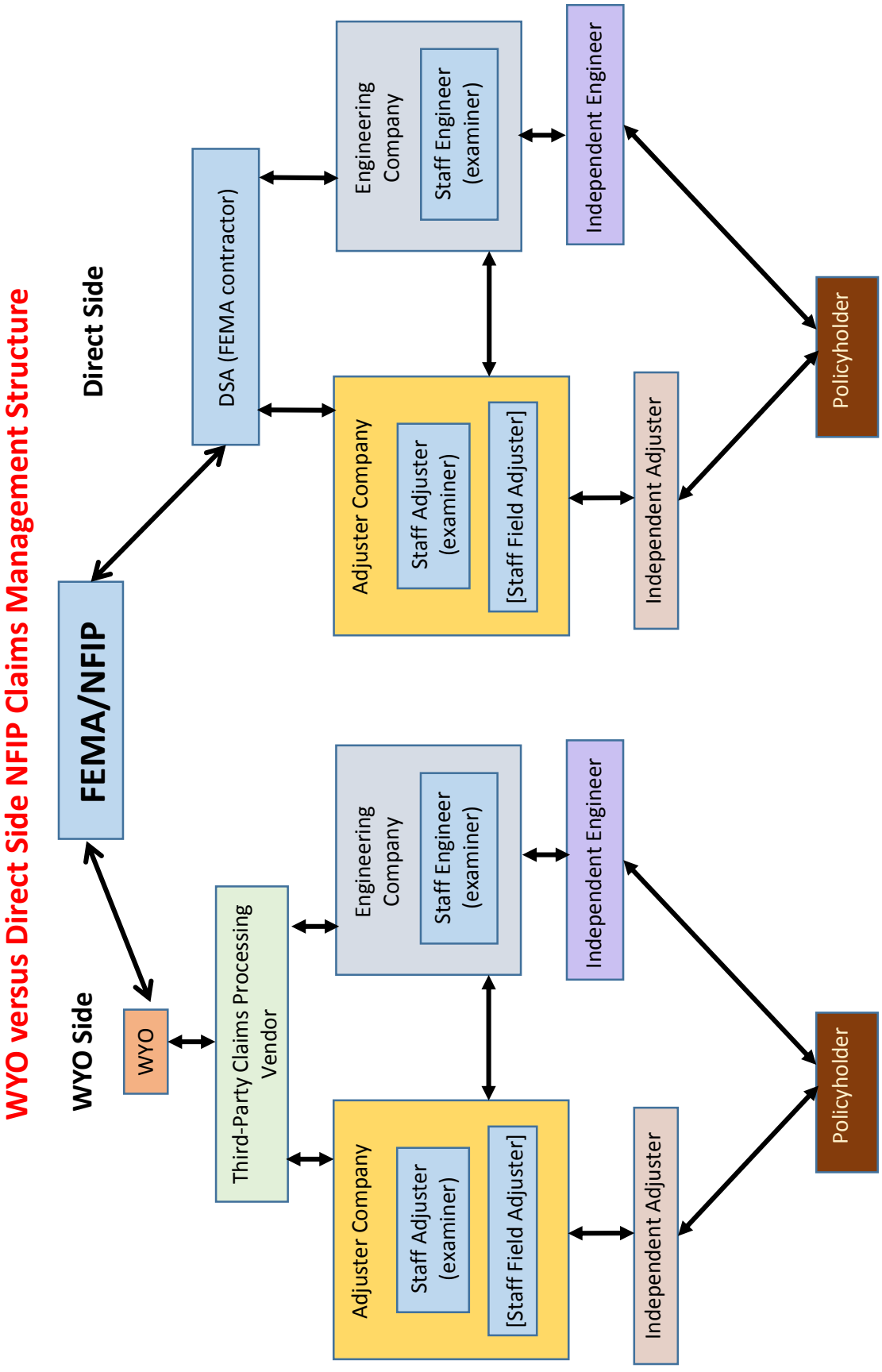
- Both the WYOs and – especially – FEMA should greatly improve their internal recordkeeping and tracking capabilities for payment errors and overall error rates in claims management. This data has been very poorly kept, but it is essential for effective oversight.

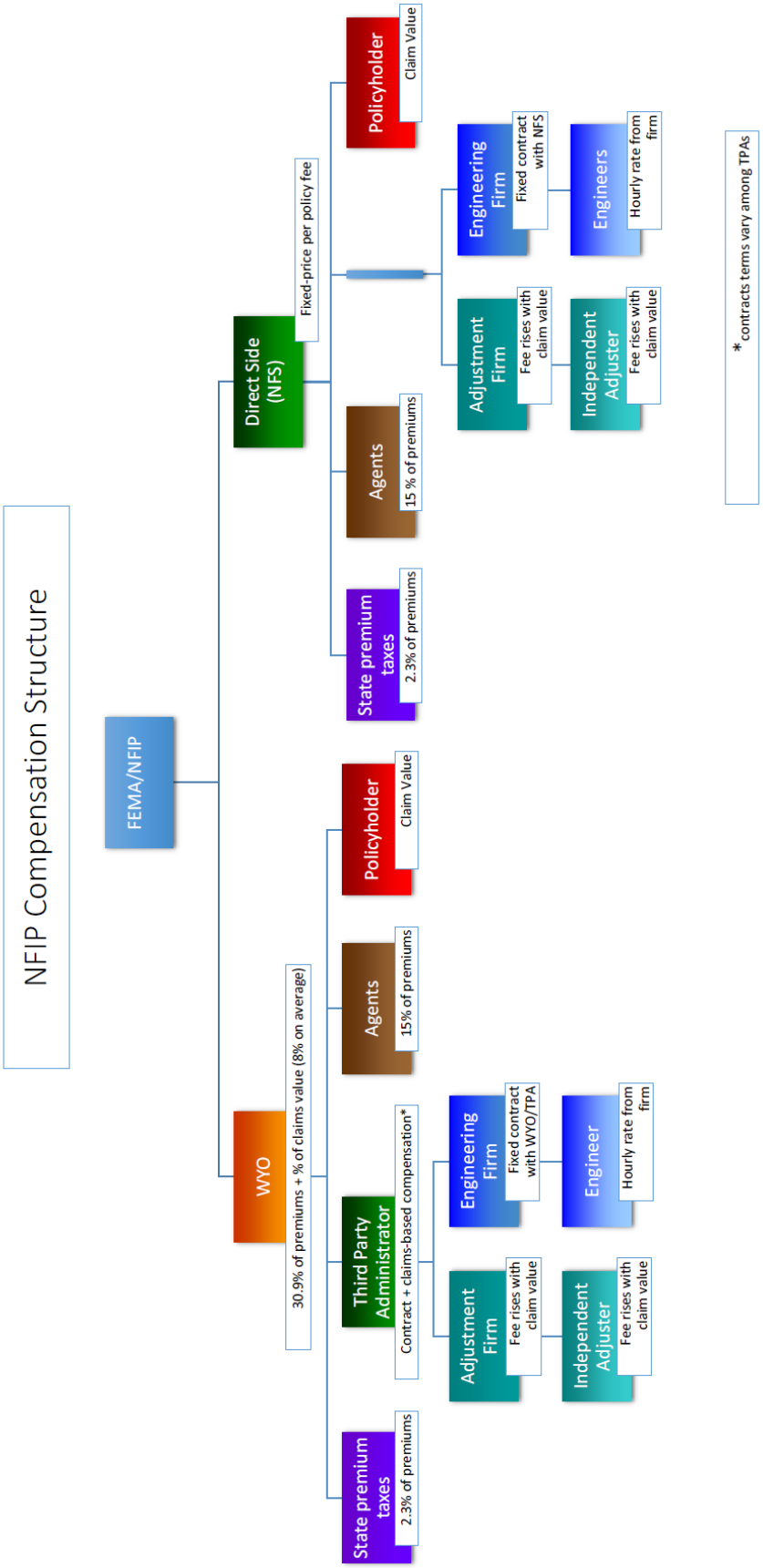
We emphasize that these recommendations will not prevent all Sandy-type problems in the future. No system or organizational model will be able to prevent all errors. These recommendations should, however, reduce the incidence of such problems and better equip the NFIP to address problems in real time and to remedy mistakes after a major flood event.

* * *

List of Acronyms

ALAE	Allocated Loss Adjustment Expense
BSA	Bureau and Statistical Agent
CRP	Claims Reinspection Program
DHS/OIG	U.S. Department of Homeland Security's Office of the Inspector General
DOC	Denial of Claim
DSA	Direct Servicing Agent
EAJA	Equal Access to Justice Act
E&O	Errors and Omissions
FCN	Flood Certification Number
FEMA	Federal Emergency Management Agency
FICO	Flood Insurance Claims Office
FIMA	Federal Insurance and Mitigation Administration (FEMA)
GA	General Adjuster
GAO	U.S. Government Accountability Office
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act
IT	Information Technology
OCFO	Office of the Chief Financial Officer (FEMA)
OMB	Office of Management and the Budget
NFIP	National Flood Insurance Program
NFS	National Flood Services
POL	Proof of Loss
RICO	Racketeer Influenced and Corrupt Organizations Act
SALAE	Special Allocated Loss Adjustment Expense
TPA	Third Party Administrator
TRRP	Transaction Record Reporting and Processing (system)
ULAE	Unallocated Loss Adjustment Expense
USF	U.S. Forensic
WYO	Write-Your-Own (insurance company)


WYO versus Direct Side NFIP Claims Management Structure
Direct Side
WYO Side
FEMA/NFIP
DSA (FEMA contractor)
Engineering Company
Staff Engineer (examiner)
Independent Engineer
Adjuster Company
Staff Adjuster (examiner)
[Staff Field Adjuster]
Independent Adjuster
Policyholder
WYO
Third-Party Claims Processing Vendor
Engineering Company
Staff Engineer (examiner)
Independent Engineer
Adjuster Company
Staff Adjuster (examiner)
[Staff Field Adjuster]
Independent Adjuster
Policyholder


NFIP Compensation Structure
FEMA/NFIP
WYO
30.9% of premiums + % of claims value (8% on average)
Direct Side (NFS)
Fixed-price per policy fee
Policyholder
Claim Value
Agents
15 % of premiums
State premium taxes
2.3% of premiums
Engineering Firm
Fixed contract with NFS
Engineers
Hourly rate from firm
Adjustment Firm
Fee rises with claim value
Independent Adjuster
Fee rises with claim value
Policyholder
Claim Value
Agents
15% of premiums
Third Party Administrator
Contract + claims-based compensation*
State premium taxes
2.3% of premiums
Engineering Firm
Fixed contract with WYO/TPA
Engineer
Hourly rate from firm
Adjustment Firm
Fee rises with claim value
Independent Adjuster
Fee rises with claim value
*contracts terms vary among TPAs

I. *Introduction*

This investigative oversight review was undertaken in light of publicized allegations that structural flaws in the National Flood Insurance Program (NFIP) had encouraged or contributed to systematic fraud in the handling of flood insurance claims in the wake of Superstorm Sandy. The purpose of the review was to provide a programmatic overview of the NFIP claims process in order to enrich and provide context for ongoing debates over flood insurance matters, and inform deliberations of the U.S. Senate Committee on Banking, Housing, and Urban Affairs (hereinafter "Banking Committee").

This review was *not* undertaken to look into any specific Sandy claims or Sandy cases presently in litigation, including the so-called "suspect engineering cases" that have received much publicity since being discussed on a broadcast of the television program *60 Minutes* on March 1, 2015. We believe these case-specific questions are poor ones for our investigative attention for several reasons: (a) these matters are already well advanced as lawsuits brought in the New York and New Jersey courts; (b) they are the subject of ongoing criminal investigation both by the New York and New Jersey attorneys general and by the Office of the Inspector General at the Department of Homeland Security (DHS/OIG); (c) many relevant documents have been seized and impounded by state law enforcement officials in connection with the aforementioned probes; (d) the question of whether specific engineering reports were actually *wrong* in their attribution of flood causality is outside the expertise of Banking investigators; (e) the three self-proclaimed "whistleblower" engineers who appeared on *60 Minutes* refused to speak to us; and (f) at the time of writing the "engineering cases" are beginning to be settled on a blanket basis in any event. It is also our judgment that it is not necessary to resolve those case-specific questions in order to provide valuable investigative insight into the structure and operations of the NFIP as a whole.

In undertaking this review, Banking investigators – from both the Majority and the Minority staffs – have conducted interviews and received documents from numerous individuals intimately familiar with the structure and operation of the NFIP. We have interviewed:

- Nine FEMA officials;
- 23 persons representing seven of the so-called Write-Your-Own (WYO) insurance carriers that have been involved in the flood program, which today have 54 percent of the policies in the NFIP and between them handled approximately 57 percent of the NFIP claims arising out of Superstorm Sandy;
- Four persons from a major flood services vendor that works for multiple WYOs;
- Three persons representing the contractor that handles all claims services on the Direct side of the NFIP and is also one of the largest claims service providers on the WYO side;
- Seven officials representing three of the largest national adjuster companies that between them worked on approximately 53 percent of the claims arising out of Sandy;

- Two individuals with extensive experience as independent adjusters, one as an adjuster for a major adjuster firm, and one as a "public" adjuster[1];

- One experienced flood damage assessment engineer;

- Two persons who work on contract for FEMA as employees of the Bureau and Statistical Agent (BSA);

- Two officials from a company that specializes in training flood claims adjusters for FEMA;

- One contractor who specializes in assisting FEMA with flood-related education and outreach;

- Two staff attorneys at a legal clinic that serves aggrieved NFIP policyholders; and

- Seven officials from various Government Accountability Office (GAO) components responsible for GAO oversight work on the NFIP.

Banking investigators also obtained documentary information, including:

- 24 FEMA claims operation review reports on claims handled by the largest WYOs in the program during the 2004-2015 period;

- Five FEMA claims operation review reports on claims handled by the NFIP's Direct Servicing Agent (DSA) spanning the 2008-2014 period;

- Data from FEMA's Claims Reinspection Program (CRP) review carried out on Superstorm Sandy claims in 2013;

- All of FEMA's Improper Payment Information Act (IPIA) and Improper Payments Elimination and Recovery Improvement Act (IPERIA)[2] reports since 2008;

- Various other reports and data summaries from FEMA, provided through iterated requests to FEMA's Office of Congressional Affairs and representatives of the agency's "Sandy Task Force";

- Several publicly-available GAO reports on NFIP management;

- An audit of FEMA management published by DHS/OIG; and

- A range of publicly-available, NFIP-related regulations, publications, and bulletins.

---

1 A "public adjuster" is an adjuster available for hire by policyholders, and is often used for such purposes as providing second opinions on damage estimates prepared by adjusters working for insurance carriers.

2 Public Laws 107-300 & 112-248.

This Report does not purport to offer the "last word" on any of the subjects discussed herein, but we hope that this Report will contribute to Congress' understanding of the NFIP problems associated with Superstorm Sandy. The following pages will discuss the findings of this review, a discussion which begins by offering a basic outline of how the NFIP's claims management process works, including the role of various participants in the process and the methods by which FEMA oversees the program and conducts quality-control audits in order to catch errors such as overpayment and underpayment. The Report then explores the various structural and operational incentives and challenges that may affect flood claims assessment and processing – including by evaluating the strengths and weaknesses of various theories that have been advanced in order to explain what are alleged to be systematic problems of error (or even fraud) in claims payments associated with Superstorm Sandy – before concluding by offering some suggestions for how to improve NFIP claims management in light of what we believe can be learned from the Sandy experience.

II. *The NFIP Claims Process*

Created by the National Flood Insurance Act of 1968,[3] the NFIP is a system for providing flood insurance to homeowners and businesses in areas of the country that lie within flood hazard zones mapped by FEMA. As detailed below, policyholders may purchase flood insurance either directly through the federal government or from private insurance carriers who participate in the NFIP. Regardless of who sells and who services these policies, however, federal law sets the terms of flood coverage in detail, specifying relevant coverage limits, as well as what types of damage will be covered and what will not. FEMA issues regulations and other guidance with regard to implementing the NFIP, and federal funds are provided through FEMA in order to pay claims made under such policies after flood events occur.

At the time of writing, the NFIP had over 5.2 million policies in force, with about $653 million in premiums. The total value of NFIP building coverage nationwide was about $1.02 trillion, along with $244.6 billion in total contents coverage. When a major flood event occurs, the NFIP may be called upon to pay out considerable sums of money to policyholders. Hurricane Katrina in August 2005, for instance, resulted in 167,969 flood policy claims, totaling over $16.3 billion, and with an average payment of over $97,000. (For an ordinary residence, the NFIP imposes policy limits of $250,000 on the property itself, and $100,000 on its contents.)

[3] Public Law 90-448.

A. *Basic Outline of NFIP Claims Handling*

Key Points:

Flood insurance claims are handled through a chain of contractors and vendors. In general, they are handled on a contractual basis by claims management vendors, who engage adjuster companies, who engage the individual field adjusters to visit flooded properties and assess damage.

Where engineering services are necessary to determine the cause of structural damage, these services are also provided by independent contractors or vendors: engineering companies who often, in turn, contract with individual field engineers.

The NFIP has a "WYO side" in which claims management is overseen by WYO insurance carriers, and a "Direct side" in which FEMA assumes this role itself, through a contractor known as the Direct Servicing Agency (DSA). The two sides of the program, however, function in essentially exactly the same way with regard to how claims are handled.

The NFIP consists of two principal components: (a) a line of business in which WYO companies market, sell, and generally oversee the handling of flood policies the contents of which are set by federal rules, and (b) a line of business in which the NFIP oversees identical flood policies directly through a contractor known as the DSA, without the intervening layer of WYO involvement. Both sides operate within the framework of NFIP rules and interpretive guidance issued by FEMA. Of the 5.226 million flood policies in the program, the Direct side currently handles about 736,000 of them (around 14 percent); the remainder fall under the aegis of WYOs which vary considerably in their policy volume. (The largest WYO handles about 953,000 policies, but there are approximately 80 WYOs in the NFIP.[4]) All flood policies are paid out with federal money from FEMA, but – as outlined below – WYOs are paid fees for their role in overseeing their policies and for serving as a pass-through for these funds.[5]

On the "WYO side," most insurance carriers contract with third-party vendors to handle claims. A handful of these specialist vendors dominate the market, though the sole WYO that specializes entirely in flood coverage does much more of its claims management internally. These vendors also sometimes handle other aspects of flood insurance policy management for the WYOs, such as underwriting. Vendors also commonly manage data reporting to FEMA on behalf of their WYO clients, such as by sending in the periodic reports that feed into FEMA's Transaction Record Reporting and Processing (TRRP) system. These vendors often also play the role of contracting for and managing specialist services that are essential to the claims management process, most of all through the hiring of adjuster companies that in turn employ the individual adjusters who visit properties in order to assess flood damage. (The ratio of in-house

[4] Some WYOs handle only a very small number of NFIP policies.

[5] With only one exception, flood insurance constitutes only a relatively small proportion of any given WYO's insurance business. Most WYOs claim that they participate in the NFIP as a convenience and accommodation to their customers and insurance agents (*e.g.*, so that customers are able to take advantage of "one-stop shopping" by purchasing flood insurance along with other insurance coverage).

staff adjusters to independent contractors varies within these adjuster companies, and especially in the wake of a major event such as Superstorm Sandy the companies will greatly augment their rosters with independent adjusters serving as independent contractors. Essentially all adjuster companies, however, have at least some in-house adjusters on staff, who serve as desk-based "examiners" in overseeing the work of field adjusters and reviewing their reports.)

As it is most commonly done on the WYO side, when claims come in to a WYO after a flood event, they are passed to the vendors for processing, and arrangements are made for specific independent adjusters to contact policyholders and make arrangements to visit the properties in question. Once there, independent adjusters "scope" the flood damage, taking the measurements and photographs and collecting such other information as they will need to write their damage estimates. Preliminary reporting is commonly sent back to their employing adjuster companies based upon this visit.[6]

After leaving the property, the independent adjuster will prepare a complete adjuster report based upon the information collected on-site during the "scoping" process, preparing highly detailed line-by-line estimates of specific elements of damage with the assistance of specialized computer software programs (*e.g.*, Simsol or Xactimate) designed to provide costing information for various types of flood damage repair.[7] This report will be forwarded back to the adjuster company for review and further passage to the vendor and/or WYO,[8] and form the basis upon which either payments will be made or coverage will be denied – usually after the policyholder has been presented with a proof-of-loss (POL) declaration, based upon the estimate, for signature. A claims file is kept for each property by the WYO and/or the policy services vendor, containing the original "scoping" information, as well as the estimation report, POL documentation, and any expert reports that have been prepared (see below). In many cases, the claims file will also contain a statement by the policyholder.

When a payment is made to the policyholder, it is typically paid on a check written by the WYO in question, but the money used to pay such claims comes from what is, in effect, a special joint bank account each WYO manages with FEMA, and which contains FEMA money (from the National Flood Insurance Fund). (FEMA replenishes these accounts with money from NFIP premiums, but in the event that insufficient funds are available – which sometimes happens in the wake of major flood events – FEMA has borrowing authority from the U.S. Treasury. In the event that this is still not enough, FEMA must request additional borrowing authority from Congress.) Policyholders are paid on their claims by the U.S. Government, therefore, and *not* by

---

6 Such preliminary data are used to help identify the scale of flood damage in an affected area and to help FEMA and the WYOs adjust reserves appropriately in order to ensure that sufficient FEMA funding will be available for that claim. In cases where a property meets the criteria for "substantial" damage, adjuster "preliminary damage assessments" are used to "help FEMA and communities identify potential substantially damaged buildings." *See* FEMA, "Adjuster Preliminary Damage Assessment," Form 086-0-20 (October 2010). Sometimes, a separate "preliminary report" is filed within 15 days of the assignment of a claims case to an adjuster. This document includes an estimated reserve amount to help guide the insurer in preparing for the claim. *See* FEMA, "Adjuster Claims Manual," *supra*, at II-5; FEMA, "Preliminary Report," Form 086-0-13 (October 2010).

7 Usually, this must be filed within 30 days. *See* FEMA, "Adjuster Claims Manual," *supra*, at II-5.

8 In addition to whatever review is done by adjuster companies themselves, most WYOs with which we spoke said they also review adjuster reports prior to making payments.

the WYOs themselves: the NFIP is a federal program for flood insurance, managed under federal rules and pursuant to FEMA guidance.

In the event that additional expert services are needed in the process of assessing flood damage, adjuster companies typically contract with specialist providers – sometimes choosing them independently, and sometimes choosing such providers from lists of pre-approved companies provided by the overseeing WYO – for this purpose.[9] After Superstorm Sandy, this was particularly common with regard to engineering services, and FEMA officials have told Banking investigators that some 16,000 of the overall total of about 144,484 Sandy claims cases involved engineering services of some form or another. If an adjuster sees structural damage at the affected property, for instance, he might recommend that an engineer be deployed there in order to assess what caused the damage. (NFIP policies contain some very specific exclusions, and payment for damage can sometimes hinge on whether particular structural problems were caused by floodwaters, hydrostatic pressure, erosion of subsoil, or settling of the ground beneath the property. Assessments are also sometimes needed with regard to *when* structural damage occurred, in order to ensure that payment is not made for problems occurring *before* the flood.) Engineers, we have repeatedly been told, serve as the "causation" experts in such cases.

An engineering company functions, in this model, much as the adjuster companies do: they will commonly employ a small in-house staff of engineers who oversee operations and review reports drafted in the field, and contract with individual engineers as independent contractors to visit specific properties. The individual engineers who are assigned to visit a property will examine it, seeking to answer whatever question has been flagged for attention by the adjuster, and will thereafter prepare a formal engineering report providing whatever analysis is needed. (Engineering reports may perhaps recommend a particular type of repair, but do not provide actual cost estimates.) These reports are passed along to the engineering company that has employed that engineer, for review there before being used by the adjuster company to inform the overall damage estimate and be included in the claim file for that property. In addition, reports are often reviewed by the vendor that has employed the adjuster company, and perhaps even by the WYO itself.

The Direct side of the NFIP functions very much as does the WYO side, with the exception merely that the DSA – which plays a role analogous to that of a WYO, and is in fact a contractor working for FEMA – contracts directly for vendor services without WYO involvement. (A single vendor, currently handles the entirety of the NFIP Direct side flood

[9] On the Direct side of the NFIP, FEMA approves requests for engineering services. Across the NFIP, all payments for engineering services also require FEMA pre-approval, though until recently FEMA required this only for per-claim expenses of $2,500 or greater. To some extent, this $2,500 threshold may have driven engineers to distort their billing by submitting claims falling just *under* this threshold in order to avoid the additional delay and paperwork associated with pre-approval. One experienced adjuster interviewed for this review indeed recalled that before FEMA started requiring pre-approval on *all* engineering expenses following Superstorm Sandy, a remarkable number of engineer expense forms would be submitted in the "$2,450-2,500 range." While it is possible that this included some inflated billing, it may also have been the case that engineering services actually costing somewhat *more* than $2,500 were submitted as bills for just *under* that amount in order to speed approval and payment. The net impact of the approval threshold, therefore, is indeterminate, and we did not conduct an extensive review of engineers' billing under the NFIP.

book.[10]) Both sides of the program, therefore, rely heavily and explicitly upon the services – and thus also the judgment – of third-party vendors, adjuster companies, engineering companies, and individual adjusters and engineers, all of whom serve as independent contractors or vendors. As it was put by one official working for FEMA's BSA – a contractor that supports FEMA management in various ways across the NFIP – the Direct side of the flood program has "exactly the same guidelines" and "should mirror the Write-Your-Own side" in these respects.[11]

This theme was echoed by experienced adjusters with whom we spoke: in its mechanics and most of its cast of characters, the Direct side of the NFIP is essentially identical to the WYO side. Perhaps most significantly, it is freely acknowledged by FEMA officials themselves. When asked about how the NFIP's Direct side manages claims issues in comparison to the WYO side of the program, for instance, FEMA's Deputy Associate Administrator for Insurance Brad Kieserman[12] readily agreed that there is basically no difference. Both sides of the NFIP, he admitted, draw upon the same universe of contractors and vendors – from FEMA's engagement of National Flood Services (NFS) as the DSA to oversee Direct side claims down through multiple layers of contractors or vendors to the field personnel who actually visit flooded properties. "Everybody's sharing the same adjusters, the same engineers," Kieserman declared, and "I'm always going to be contracting for services. … All we do is contract to get the work done."[13] (Nor is the handling of claims overpayments or underpayments any different between the two prongs of the program: FEMA's DSA contractor on the Direct side is liable for the recoupment of overpayments just as WYOs are on the other side, as discussed below.)

---

[10] NFS, however, was not the Direct side vendor at the time of Superstorm Sandy. At that point, the NFIP contractor managing all Direct side claims was the company CSC Covansys. (NFS subsequently purchased that company's flood business.)

[11] Sometimes the two sides of the program seem to run so similarly that FEMA itself apparently becomes confused between them. In one claims operation review report on the Direct side of the program, FEMA added a "WYO fee" to the amount it assessed to have been overpaid. The DSA responded, however, by reminding FEMA that "[t]his is a DSA claim so there is no WYO 'fee'."

[12] This was Kieserman's title and role at the time he was interviewed, on multiple occasions, by Banking investigators. Kieserman, however, has since left FEMA.

[13] Even FEMA's current high-profile Sandy Task force requires contractor support, with "up to 140" contract adjusters from major adjuster companies, for example, being employed to support the 80 full-time FEMA employees on the Task Force.

B. *Oversight and Accountability*

(1) *Adjusters and Engineers*

Key Points:

FEMA certifies which adjusters are permitted to participate in the NFIP, but does not provide training in *how* to do flood adjusting, which is left to the adjuster companies themselves. Engineers are subject neither to FEMA certification nor to any flood-specific training regimen.

After a major flood event, the demand for such experts can exceed their supply. The resulting claims caseload requirements can lead to experienced adjusters and engineers becoming overwhelmed and/or the NFIP bringing in a surge of less qualified adjusters or engineers who are more likely to make mistakes in the field.

Adjuster and engineering companies commonly employ experienced staff experts to review reports by field personnel in order to protect against such errors.

(a) *Qualifications*

The qualifications and experience of the experts most intimately involved in assessing flood damage – specifically, the individual adjusters and engineers who actually visit damaged properties and prepare the reports on the basis of which claims are paid both on the WYO side and the Direct side of the flood program – are critical elements to ensuring the integrity of the NFIP's claims management system.

In order to participate in the NFIP, an adjuster must have a Flood Certification Number (FCN) provided by FEMA, which requires each adjuster to attend a one-day seminar each year at which training is provided on the contents of NFIP flood insurance policies, including coverages, exclusions, and interpretations. (FEMA certification is available at five different levels of certification: for single-family dwellings; mobile homes; small commercial properties; large commercial properties; and condominium properties.) FEMA does not, however, provide any training beyond this, and in fact apparently prohibits NFIP seminars from addressing "how to" issues (*e.g.*, providing specific instruction in how to estimate flood damage) in order to avoid being seen as somehow pressuring adjusters to take any particular approach or endorsing any such approach. Instead, for such "how to" training, FEMA relies upon the requirement that adjusters have at least four years of experience in adjusting property loss claims in *other* contexts[14] (*e.g.*, homeowners' insurance claims) before they will be permitted to adjust flood claims on their own. [15]

[14] For large commercial property claims and those relating to multi-residence condominiums, the NFIP requires *five* years of prior experience.

[15] FEMA does not require adjusters on the staff of adjuster companies (who are sometimes known as "examiners") to have NFIP flood certifications, though it encourages this. *See* FEMA, "Adjuster Claims Manual" (September 2013 revision), at II21, *available at* https://www.nfipservices.com/DesktopDefault.aspx?tabindex=5&tabid=35.

As a result, adjusters are to some extent necessarily untrained and inexperienced in flood adjusting when they first start doing NFIP work, though major adjuster companies, flood service vendors, or WYOs tend to provide adjusters with flood-specific training on their own – including specific training in how to write estimates – in order to improve quality control. Banking investigators have been told, for instance, that it is not uncommon for adjusters new to the flood insurance program to "ride along" with a more experienced "mentor" adjuster on NFIP claims for some period of time – contributing to reports that are filed under the FCN of the supervising adjuster – before such persons are deemed capable of adjusting under their own FCN.[16] (This FEMA-sanctioned mentoring with more experienced adjusters, in fact, has been described as a way for adjusters to gain entry into the NFIP *without* a full four years' worth of prior adjusting experience.[17])

Engineers doing work on NFIP claims are not subject to any sort of FEMA certification or training requirements, though individual engineers will be subject to state licensure requirements at least in their state of origin, and certain states may prohibit engineers from practicing there unless they have a state license.[18] (This apparently does not prevent unlicensed engineers from working for engineers who *are* locally licensed, however, with the licensed engineer vouching and taking credit for work prepared under his supervision.) Some WYOs require that engineers have local licenses, but there is, in any event, no requirement of flood-specific experience.

(b) *Supply of Personnel*

Banking investigators have been told by many participants in the process that in the wake of a major flood event, the demand for such expert services can far exceed the supply, setting off a fierce scramble for adjusters and engineers to handle the resulting caseload and sometimes creating problems as inexperienced experts are pressed into service. This seems to have been very much the case after Superstorm Sandy, when FEMA's BSA found it necessary to undertake "emergency certification of adjusters" by putting some 500-600 new adjusters through a special iteration of the standard daylong training seminar on NFIP policy coverage in order to help meet the sudden spike in demand.

The extent of this problem of personnel supply can perhaps be seen in the fact that according to one senior contractor with the BSA there were initially only some 4,000-4,500 adjusters available at the time for fieldwork, but there ended up being 144,484 Sandy flood

---

[16] At least one state *has* fined some adjusters involved in Superstorm Sandy adjustment work for unlicensed practice. In 2013, for instance, it was reported that New Jersey had brought cases against some out-of-state licensed adjusters – including some who came to New Jersey as *public adjusters* in order to "represent storm-struck home and business owners in their negotiations with insurance carriers." Ed Beeson, "Hurricane Sandy insurance complaints lead to NJ enforcement actions against adjusters," *NJ.com* (September 24, 2013), *available at* http://www.nj.com/business/index.ssf/2013/09/hurricane_sandy_insurance_comp.html.

[17] *See* AdjusterTrainer.com, "NFIP Mentor Program" (undated), *available at* http://www.adjustertrainer.com/mentor-program/.

[18] In the 2014 training module it provides for the adjuster community, FEMA advises that it "prefers" that engineers be "State-licensed."

claims.[19] Multiple interview subjects told Banking investigators about challenges experienced in finding qualified and experienced personnel under those circumstances, about a resulting tendency sometimes to rely for such work upon whomever happened to be available, and about the widely-varying quality and consistency of the work that was consequently done in the field.

We heard repeated anecdotes about such things as caseload pressures resulting in some adjusters used in the wake of Superstorm Sandy being "just *so* unqualified," and about how "anyone with a license" was permitted to provide engineering consultations as the program called upon all available "warm bodies for engineers, just to get [claims] moving." Representatives of one WYO claimed even to have heard of *electrical* engineers being employed to handle flood claims in some cases.[20] A FEMA claims operation review in 2014 of Direct side claims – that is, the annual audit of DSA claims that covered the period of Superstorm Sandy – noted that "a considerable number" of claims showed multiple errors, both in overpaying and underpaying, and observed that "[i]t is a fair presumption [that] this type of loss estimate is common to an adjuster who lacks training in the aspect of basic construction practices or adequate supervision by the adjusting firm."[21] Such problems seem to have been common in connection with Sandy.[22]

This supply-of-personnel problem even affected the personnel used in FEMA's own CRP review of Sandy claims, which uses experienced "General Adjusters" (GAs) on contract to FEMA to reinspect a random selection of claims on both the WYO and the Direct sides of the flood program in the wake of a major flood event (see below). Specifically, for Sandy, FEMA had to hire additional adjusters to supplement the BSA's existing GAs, bringing in these new personnel to play a role that theoretically should be filled only by highly experienced adjusters working as full-time FEMA contractors. According to James Sadler, former head of the Claims and Appeals Branch at FEMA's Federal Insurance and Mitigation Administration (FIMA), some of these supplemental GAs did poor work, and required subsequent review and correction by more experienced personnel.[23]

---

[19] The total number of FEMA-certified adjusters, we have been told, was higher – perhaps in the 8,000-9,000 range nationwide – but this included personnel on the staff of adjuster companies who did not do field inspections and individual adjusters who did not happen to be available for Sandy work. By comparison, just over 6,000 persons attended the annual NFIP training seminar in 2014, though by some accounts many of them were *not* individuals hitherto, or usually likely to be, working a major proportion of their time in the flood program. One experienced adjuster estimated to us that of the total number of persons possessing NFIP certification – which, as noted, might perhaps be as high as 9,000 – only between 1,200 and 1,500 actually had much experience doing flood work.

[20] In another anecdote recounted to Banking investigators, an adjuster reportedly spent a total of about five minutes adjusting flood damage at the house of a blind and impoverished senior citizen.

[21] In one of the Sandy claims reviewed in that Direct side audit, the FEMA auditors observed that the information in the claim file "indicate[s] the lack of adjusting experience and supervisory oversight, which create overpayments and underpayments, as well as customer service related issues."

[22] Adding to the difficulty facing adjusters in the field, some Sandy inspections were also initially hindered by problems in getting access to the properties in question as a result of flooding and other hazards. One FEMA claims operation review of a WYO during the Sandy period, for instance, noted that "[m]any of the claim files from Sandy had late Preliminary and Final Reports. FEMA understands the hardship that adjuster's [sic] had getting to the site …."

[23] A BSA employee told Banking investigators that the 10 GAs were supplemented by an additional four "disaster assistance" personnel hired for that temporary purpose. In Sadler's words, these auxiliaries did such "sloppy

Analogous mechanisms of review are, in fact, quite common in the adjuster and engineering communities, with adjuster companies and engineering companies both frequently employing supervisory staff experts who review field reports precisely in order to help correct for problems that might be created by inexperience or simple error under the trying circumstances of real-world field conditions and caseload-management pressures after a major flood event. So-called "peer review" procedures have become very controversial after allegations that some Sandy engineering reports were *improperly* altered by the engineering companies, but it remains important to have some form of quality control built into the system – especially under the chaotic and stressful circumstances likely to prevail after a major flood event.

(2) *Claims Operation Reviews*

Key Points:

FEMA attempts to ensure quality control in claims management by subjecting both WYO and Direct side participants to claims operation reviews in which a random sample of claims files are reviewed for errors.

An error rate of 20 percent or greater results in additional FEMA auditing. Persistent error rates will result in FEMA requiring the adoption of a remedial plan, and can in theory result in a participant being expelled from the NFIP.

All payment errors found in such audits are "critical errors" and must be fixed. Overpayments are to be reimbursed to FEMA, and underpayments are to be remedied by paying the policyholder accordingly.

All WYOs participating in the NFIP, as well as the contractor that handles policies for FEMA on the Direct side of the program, are subject to "claims operation reviews" by FEMA in order to help ensure accuracy in processing claims.[24] These reviews are conducted triennially for WYO companies, and annually on the Direct side.[25] This is not the only type of review that occurs, for company financial information is subject to review by annual FEMA audits, and once

and imprecise" work that it was necessary to look over the CRP data once more – this time with *real* GAs – in order to police for errors. This resulted in the final, authoritative CRP data being significantly different from the initial data, after reviewers determined that a large number of the overpayments first identified were not actually overpayments after all. (The BSA employee, however, said he recalled no problems with these officials' work.)

[24] In addition to the claims operation reviews, FEMA conducts triennial underwriting operation reviews for every WYO participating in the NFIP, and annually for the DSA contractor. The term "triennial" is something of a misnomer, for they do not always occur every three years. Rather, these reviews typically take place *three years after the close-out date for the last review*. Since it can sometimes take some weeks or perhaps even a few months to resolve all the issues raised in any particular audit and prepare an audit report, this means, in practice, that they may occur less regularly than every 36 calendar months.

[25] The largest WYOs – those having 100,000 policies or more – are audited every three years on their own. Companies with fewer than 100,000 policies may be combined with other companies that use the same vendor, so that their reviews occur simultaneously (*i.e.*, with FEMA officials only having to visit that vendor's location once in order to audit all the relevant companies).

every two years, each WYO is required to retain an independent certified public accounting firm to examine its finances – *e.g.*, underwriting, premium collection, reserves, and payments out and in. As described below, there is also a process of claims reinspections that occur in connection with specific flood events or specific requests by WYOs for such assistance. Finally, FEMA can also conduct an audit "for cause" at its own discretion, though these are reportedly rare.[26] It is very important to understand the claims operation review process, however, for it represents the NFIP's "baseline" process for assessing the adequacy of claims management.

The process begins with FEMA selecting a random sample of claims files to be reviewed from the company in question, typically about 100 files. A small team of FEMA officials will travel to the facility where these files are kept – which might be at the offices of a WYO but is more commonly at a facility operated by the vendor that has been retained by the WYO to do claims management – and, over the space of several days, go over each file in detail, often accompanied by a WYO and/or vendor company representative. All information in each claims file is examined, including scoping notes (*e.g.*, measurements and photographs taken by the adjuster on the scene), the adjuster's report, any engineering or other expert report that may have been prepared, POL documentation, and any other recorded statement from the policyholder.

At the end of the process, FEMA will provide the company with a sort of "report card" of its findings, which will include identifying the rate of errors found in the sample reviewed with regard both to "critical" and "noncritical" errors. (Noncritical errors are most commonly "procedural" mistakes, such as an adjuster failing to submit a preliminary report within 15 days of assignment of a claim, but anything related to payment errors is deemed "critical."[27]) FEMA typically provides the company with a draft report of its findings, after which its experts discuss particular problems with corporate officials, who are given a chance to rebut them. FEMA then finalizes its findings after determining whether it either agrees or disagrees with any such rebuttal.

A company will be deemed to have failed its claims operation review if its rate of critical errors found during the review period reaches or exceeds 20 percent – that is, for instance, when critical errors appear in 20 claims out of a typical 100-file sample.[28] In addition to keeping the

---

[26] FEMA officials James Sadler and Jordan Fried, Acting Director of FIMA's Risk Insurance Division, could not remember when the last such "for cause" audit had occurred. (FEMA apparently did not consider the allegedly improper behavior of one insurer during Hurricane Katrina – the alleged fraudulent mischaracterization of wind damage as water damage in order to shift insurance payment costs to FEMA, which led to a U.S. Department of Justice Investigation – as rising to the level that would require an audit for cause.) Other FEMA officials, however, recounted that one "for cause" audit had been done in connection with Superstorm Sandy, after concerns arose at FEMA about the slow speed at which one WYO was processing claims. *See also, e.g.*, Government Accountability Office, Report to Congress, "National Flood Insurance Program: FEMA's Management and Oversight for Insurance Company Services Should be Improved," GAO-07-1078 (September 2007), at 35-36 (discussing extreme rarity of "for cause" auditing).

[27] According to FEMA's James Sadler, counting improper reserves calibration as a critical error is a relatively recent phenomenon.

[28] According to FEMA's James Sadler, in past years FEMA deemed three noncritical errors in the same claims file to add up to one critical error – such that a large number of noncritical errors could push a company above FEMA's critical error rate threshold – but this is no longer the case. Banking investigators were also told that if there were an extremely obvious problem with an engineering report – such as its having been prepared by an *electrical* engineer unlikely to know anything about structural damage caused by floodwaters – this might also

critical error rate under this threshold, FEMA requires the correction of all errors that are discovered in the sampled claims files. This means, for instance, that all payment errors found therein must be fixed. Underpayments are remedied by the issuance of follow-up payments of FEMA funds to the policyholders in question, while overpayments are reimbursed *to* FEMA so it does not end up having paid for anything not actually owed to the policyholder. (See below for a more extensive discussion of remedying payment errors.)

If a company is found to have an unacceptable (*i.e.*, 20 percent or greater) rate of critical errors, this triggers a requirement for an additional FEMA audit within the next year. If FEMA finds in this follow-up audit that there is still an excessive error rate in claims processing, the WYO company may be summoned to appear before the NFIP's "Standards Committee," where it might be required to develop and implement a corrective action plan, and might conceivably be subject to suspension from the NFIP. (This, however, is very rare. GAO has reported, for instance, that in the early 2000s, a WYO left the NFIP "in part because of issues raised in claims operation reviews and in part to other financial problems,"[29] but this phrasing is somewhat ambiguous and NFIP participants with whom we spoke could not recall a clear example.[30])

The abovementioned Standards Committee is a group made up of five industry (*i.e.*, WYO) representatives, five officials from FIMA, and one representative of FEMA's Office of the Chief Financial Officer (OCFO). The Committee usually meets three times each year – though in an audit report published by DHS/OIG in May 2014, it was faulted for having *failed* to meet since April 2012.[31] (FEMA claims that it meets regularly now.)

(On the Direct side of the NFIP, the claims operation review process functions similarly, except that reviews are not done on WYOs – for there *are* no WYOs on the Direct side – but on NFS, which handles FEMA's Direct caseload on contract. These reviews are done on an annual basis.[32] Otherwise, they proceed similarly, typically reviewing a 100-file sample upon each iteration.)

count as a critical error. (Sadler said that he recalled FEMA ordering the preparation of new engineering reports "a couple of times" during his career with the NFIP.)

29 Testimony of William O. Jenkins, Jr. before the House Financial Services Committee, Subcommittee on Insurance and Community Opportunity, "National Flood Insurance Program: Oversight of Policy Issuance and Claims," GAO-05-532T (April 14, 2005).

30 According to one of our interview subjects, at one point a particular WYO left the NFIP, on a purportedly voluntary basis, just before being ejected.

31 DHS/OIG, *National Flood Insurance Programs Management Letter for FY2013 DHS Financial Statements Audit* (OIG-14-92) (May 5, 2014). This audit report, prepared for DHS/OIG by the accountancy firm KPMG, also complained that as of July 2013 the Committee had had five positions vacant for the previous two months. FEMA says that vacancies are now filled promptly.

32 According to FEMA's James Sadler, claims operation reviews are annual on the Direct side but triennial on the WYO side "just to make it look good."

(3) *Claims Reinspection Program*

Key Points:

FEMA's Claims Reinspection Program (CRP) employs experienced General Adjusters (GAs) to spot-check damage estimation at already-adjusted properties after a major flood event. These GAs review a randomly-selected sample of claims files from the event in question. FEMA requires that error rates be not more than three percent.

FEMA's CRP – run by a vendor known as OST, Inc., currently serving as the BSA – is a process by which claims are subject to reinspection by the BSA's experienced GAs in connection with a particularly large flood event.[33] Routine CRP reinspections are generally randomly selected by flood event, size of loss, or class of business, as applicable, pursuant to a "binomial sampling chart" that dictates the appropriate number of files to be reviewed based upon the WYO company's total number of claims. The claims information on the basis of which files are selected for reinspection using the binomial table comes from FEMA's TRRP system, into which WYOs regularly report claims information.[34]

WYOs with 400 or more claims in any particular FICO designated flood event are subject to routine reinspection, and representatives typically accompany the GAs on such visits. (Smaller companies also are eligible "as staffing and time allow" for the contractor serving as the BSA. FEMA also conducts reinspections of claims on the Direct side of the NFIP.) Reinspections are conducted principally (but not exclusively) on open claims files, and the properties in question are commonly revisited.

In CRP reinspections, a company is held to a three percent error rate; should the rate of errors (*e.g.*, overpayments or underpayments) exceed this threshold, additional training needs to be provided for claims adjusters and files may be pulled for review. If a large company's error rate is found to exceed 10 percent in any given month or three percent twice in any six-month period, "additional training" will also be required for the entities involved and additional action – such as the development of a "corrective action plan" – may be mandated at FEMA's discretion. (Smaller WYOs will be subjected to such additional measures if their error rate exceeds three percent more than three times in an 18-month period.)

[33] Reinspections are generally associated with the establishment of a Flood Insurance Claims Office (FICO), an NFIP claims processing office set up in a catastrophe area when a sufficient number of flood claims have resulted from a single event.

[34] GAs also have the authority to select specific files for reinspection if they have reason to believe that problems may exist therein. Provision is also made for "Special Assist" reinspections, which generally take place at a WYOs request and involve specific claims situations that require a GA's attention. They also can be ordered by FEMA in "unusual situations" such as where a large number of condominium losses or other complex problems have arisen.

(4) *Supplementing and/or Appealing Claims*

Key Points:

In theory, the NFIP offers policyholders the ability to obtain supplemental flood insurance payments – *e.g.*, for damages not noticed earlier, or if the cost of repair exceeds original estimates.

Policyholders can also appeal denials of coverage through an internal FEMA process, and may also bring suit in court.

Even before issues of actually *appealing* claims determinations come up, an NFIP policyholder has the ability to submit documentation in order to demonstrate additional damages or costs not included in the adjuster's report (*e.g.*, for repairs that turn out to cost more because of rising material prices in the wake of a flood, or for damage the policyholder believes was initially missed by the adjuster). If, during the process of contesting a decision, the policyholder submits documentation that meets FEMA standards, the agency will provide additional money. Similarly, the policyholder may also submit documentation to his or her WYO carrier in order to demonstrate additional damages or costs.

In addition to this process for submitting supplemental claims information, the policyholder can also appeal a denial of coverage (DOC) determination directly to FEMA within 60 days of receiving a DOC letter for some specific flood damage by providing a copy of that letter and POL paperwork, which is then reviewed by FEMA's Claims and Appeals Examiners. (The availability of and procedures for this appeals process, are spelled out in the NFIP Flood Insurance Claims Handbook given to policyholders when they initially take out flood insurance, at every point they renew it, and at the time of a claimed loss.) An additional avenue for redress is for policyholders to bring a lawsuit in federal court, which must be done within one year of the DOC. (The appeals process and its weaknesses are discussed in more detail below.)

Furthermore, while there has hitherto been no provision in the NFIP for mediation of claims *per se*[35] – though FEMA may be in the process of establishing a mediation program on an *ad hoc* basis for Sandy claims that are *reopened* pursuant to the procedures announced by FEMA in May 2015[36] – there does exist a procedure for mediation on specific issues of valuation (*e.g.*, of particular items damaged in a flood).

[35] Section 100223 of the Biggert-Waters Flood Insurance Reform Act of 2012 (Title II of Public Law 112-141) provides for FEMA participation in disaster claims mediation programs in the various *states*, but it does not address issues of mediation of claims under federal flood insurance policies.

[36] *See* FEMA, "Hurricane Sandy National Flood Insurance Program Claims Review Process" (updated May 19, 2015), *available at* http://www.fema.gov/hurricane-sandy-national-flood-insurance-program-claims-review.

III. *Participant Incentives*

Key Points:

NFIP participants face complex incentive structures, but there does not seem to be a clear net incentive either to underpay or to overpay policyholders.

Even if a WYO did perceive an incentive to engage in systematic underpayment, there does not appear to be a clear or reliable way in which it could direct outcomes in the field in order to implement such a strategy.

Because similar claims management problems are alleged to occur both on the WYO side of the program *and* on the Direct side where no WYOs are involved, moreover, it is difficult to identify WYO incentives as being a cause of these difficulties.

Theories of "systematic underpayment" are also inconsistent with the actual data produced by FEMA auditing – which, if anything, suggest a general pattern in which claims *overpayment* is actually more common than underpayment.

This review has sought to evaluate concerns that the NFIP's compensation structure for WYO companies provides them with an incentive systematically to "lowball" assessments of flood damage to policyholders. According to this argument, this incentive to underestimate flood damage comes from the source of the funds used to make up each of the two types of payment errors found in FEMA claims operation reviews and claims reinspections. As noted earlier, if a FEMA audit reveals that an underpayment has occurred in a particular case, the policyholder is paid for the amount of this underpayment by the relevant WYO carrier using FEMA money. By contrast, in cases in which *overpayment* is found, WYO companies are required to reimburse FEMA for this overage from the WYO company's own funds – or perhaps from its contract vendor, the adjuster company involved, or even the individual adjuster in question, depending upon their particular contractual relationships – rather than FEMA.[37]

As a consequence of this difference in *the source* of the funds used to correct each of the two types of payment error found in a FEMA audit, it is claimed, the WYOs feel a general incentive to underpay on flood claims. With overpayments having to be paid out of pocket – being, as it were, "clawed back" by FEMA – but underpayments being made good with FEMA money, it is said, the WYO companies systematically "lowball" flood claims as a way to

[37] Banking investigators were told that FEMA currently looks to the WYOs – or, on the Direct side, to the DSA – for reimbursements. But FEMA does not appear to *prohibit* these participants from reaching out, in turn, to policyholders. In 2011, in the wake of widespread reports of claims fraud in connection with Hurricane Katrina, FEMA created a special "revised recoupment process … for the administrative collection of debts" which provided for recouping overpayments from "individual disaster applicants" by sending them "notices of debt." *See, e.g.*, FEMA, "Collection of Overpayments" (February 24, 2011), *available at* http://www.regulations.gov/#!documentDetail;D=FEMA-2009-0003-0001. Even today, moreover, FEMA permits the DSA to pursue policyholders for reimbursement, provided only that FEMA's DSA contractor does not identify itself as FEMA. The DSA contractor has confirmed to Banking investigators that FEMA does not prohibit such recoupment from policyholders, and indeed that its contract with FEMA envisions this by providing procedures for doing so.

minimize their chances of having themselves to pay to correct overpayment errors. This argument about underpayment incentives has been a centerpiece of repeated public contentions that widespread and systematic fraud occurred in the processing of Sandy claims.

Because this "fear of clawback" thesis has attracted so much attention, this review undertook carefully to examine the structure and operations of claims management within the NFIP in order to understand and assess the various incentives facing all major participants. Four points are of particular importance in this regard:

- First, we found that these various incentive structures are complex, and while different pressures may indeed have existed – either being built into the NFIP's compensation structure or arising as participants scrambled to handle the enormous caseload created by Superstorm Sandy – these incentives tended to point in different directions.

- Second, given the attenuated agency relationships that characterize the WYO side of the flood program, it was also far from clear how a single WYO (let alone multiple WYOs) would be able reliably to skew outcomes on the ground even if an incentive to underpay *did* exist.

- Third, the fact that characteristic Sandy-related problems also occurred on the Direct side of the NFIP – where FEMA oversees claims management with no intervening layer of WYO involvement at all – makes it difficult to conclude that whatever WYO incentives do exist are at the root of FEMA's Sandy problems. The alleged role of the WYOs has received much attention in the media, but the evidence suggests that they are *not* the source of the problem: the flood claims process is no less problematic on the Direct side of the program, where WYOs have no role and FEMA oversees things itself. (Indeed, reinspection data suggests that the Direct side *underpaid* Sandy policyholders with greater frequency than did the WYO side.) The WYO and Direct sides, moreover, share the management challenges created by attenuated chains of control and oversight: there is essentially no difference between the two prongs of the program in this regard, and Sandy-related problems seem no more likely to arise in one than the other. Whatever the merits and demerits of WYO participation might be, therefore, the available information does not support the conclusion that the WYOs are at the root of the NFIP's current problems.

- Finally, the theory of systematic underpayment is not consistent with the actual data available from FEMA's claims operation reviews for the largest WYOs and from CRP resinspections undertaken in the wake of Superstorm Sandy. These data show no general pattern of consistent underpayment, fairly low error rates of any kind – and, if anything, claims operation reviews indicate pronounced tendency toward *overpayment* of WYO and DSA flood claims.

Ultimately, it was not possible to reach a clear conclusion about the net impact of the various and sometimes-conflicting incentive structures that exist within the NFIP, except that the information available to date does not sustain broad theories of widespread collusion and fraud aimed at underpaying policyholders While our review cannot speak to whether or not the willful

falsification of flood damage analysis occurred in any particular Sandy case or cases, of course, *no* theory of "systematic" or "structural" incentives or biases seems consistent with the information we have seen. The following paragraphs explore these questions in more detail.

A. *Overpayments versus Underpayments*

Key Points:

The available evidence does not support the existence either of any general incentive to underpay policyholders or any practice of doing so. Such claims as have been publicly made to this effect are merely anecdotal, and are undercut by the available evidence.

Data from claims audits of WYO participants and the DSA show, on the whole, very low overall rates of "critical errors" (*e.g.*, payment errors) in NFIP claims files. Indeed, overpayments are more common than underpayments in this claims operation review data, and the aggregate value of overpayments on claims is considerably higher. These detailed audit reports are inconsistent with "pattern of underpayment" allegations.

FEMA's CRP reinspections of Sandy-related claims management also show a very low overall error rate, as well as a predominance of overpayments. These data also undercut "pattern of underpayment" allegations.

FEMA's reporting under the Improper Payment Information Act (IPIA) and Improper Payments Elimination and Recovery Improvement Act (IPERIA) also shows low overall error rates. While caution must be used in interpreting these data, because they do not extrapolate to the overall universe of NFIP payments, they nonetheless broadly corroborate a finding of low error rates in the program because IPIA/IPERIA file selection is not random but rather based upon an effort to evaluate types of claims in which errors are understood to be *especially* likely.

The basic premises of the abovementioned "incentives" argument, at least, do appear to be true: it is clearly the case that if found during the course of a FEMA review, underpayments in particular cases will be rectified through the use of FEMA money, whereas overpayments must be paid "out of hide" by the various WYOs, vendors, or adjusters involved. It might well be true, therefore, that – in this narrow sense, at least – it would be more undesirable for an overpayment to be revealed in an audit than an underpayment, though both would result in a critical error.

In order to conclude that the existence of an incentive to avoid overpayment drove participants to devise and implement a *strategy* of "lowballing" claims, however, it would presumably also have to be the case that: (a) there actually *was* a fear of "clawback" sufficient in magnitude, and in the degree of its perception across the industry, to overpower whatever incentives might exist to get claims "right" (or at least not to underpay); (b) a "lowball" strategy would have to emerge from the balance of incentives as the best, or at least a preferable, approach to profit-maximization for players able to influence claims estimation and/or payment; and (c) these players would actually have to have implemented such a strategy, as could perhaps

be inferred from the existence of a persistent pattern of underpayment as revealed through statistical sampling and review of actual claims files. On the basis of the information available to date, however, the links in this chain of argumentation do not stand up well to scrutiny.

To be sure, this review did adduce at least some anecdotal evidence supportive of the "fear of clawback" argument. Specifically, one public adjuster told Banking investigators that WYOs and adjuster companies seemed to him to have had a "fear of clawback" – that is, a worry that if they were found by FEMA to have overpaid on a claim, their institution might have to reimburse FEMA out of its own pocket for the overage.[38] By itself, however, it is difficult to read too much into what he himself conceded was merely "anecdotal" evidence, particularly because the individual in question has not actually worked at adjusting homeowner flood claims since 2008 (*i.e.*, four years before Superstorm Sandy)[39] and his principal contact with more recent NFIP cases has been through his consulting work for Sandy plaintiffs' attorneys and his contact with aggrieved policyholders who brought their cases to a law school flood claims clinic for which he now does volunteer work.[40] Additionally, he admits that adjusting companies and, in many cases, individual adjusters routinely carry "errors and omissions" (a.k.a. "E&O") insurance, which might protect them to some degree against having to pay back flood overpayments out of their own pockets and thereby likely attenuate any "fear of clawback" they might otherwise have.[41]

Another comment that has been cited as evidence for this "clawback" theory comes from a July 30, 2014, hearing of the Subcommittee on Housing, Transportation, and Community Development of the U.S. Senate Committee on Banking, Housing, and Urban Affairs,[42] at which Donald Griffin – vice president of the Property and Casualty Insurers Association of America – was asked about the issue. In this hearing, Griffin was asked whether concern about having to

---

38 One additional interview subject, from a claims processing vendor, claimed to Banking investigators that participants in the NFIP are "absolutely afraid of overpayments." This person, however, only made this comment in discussing a question that fell in the "grey area" where a *bona fide* judgment call might be made in either direction – that is, in a context that *rules out* fraud, because either option was assumed to be legitimately available. Nor, in any event, did the person provide any evidence for this claim or, when asked, cite any specific examples of who felt this way and why this would be the case.

39 The only specific account this adjuster appears ever to have offered about an insurance company pressuring him or any other adjuster to downplay flood damage is a single anecdote dating from his work on one flood claim after Hurricane Ike in 2008. (Though this very specific story has been a prominent feature of his media comments in May 2015, he had failed to mention it – even when asked what support he had for his "clawback" theory – when interviewed by Banking Investigators in April of that year.)

40 These are not contexts in which he is likely to have seen a particularly representative cross-section of the 144,484 Sandy claims cases. In fact, staff attorneys for the law school clinic for whom that adjuster does volunteer work indicated that the clinic chooses only the most "egregious" cases to prosecute.

41 E&O insurance is not a panacea, however. According to one experienced adjuster with whom we spoke, and to FEMA's James Sadler, an adjuster might choose to pay back *smaller* overages out of his own pocket rather than risk seeing his E&O premiums rise – or might even *have* to do so if his E&O policy has a substantial deductible. One adjuster even suggested, moreover, that E&O coverage is often not available unless and until a WYO (or perhaps FEMA on the Direct side of the NFIP) formally *sues* an adjuster for such recoupment.

42 Subcommittee on Housing, Transportation, and Community Development, U.S. Senate Committee on Banking, Housing, and Urban Affairs, "The Flood Insurance Claims Process in Communities: Lessons Learned and Potential Improvements" (July 30, 2014), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.LiveStream&Hearing_id=08ca0184-7a27-4b0b-bfaa-95c9807adf9a (archive webcast).

pay "clawback" might make a company "think twice before settling on the larger of two equally well supported claim values" and whether the disincentive to overpay might "outweigh" the disincentive to underpay. Griffin conceded that it was possible that this was the case, but stressed that because "we do not have the data to know how this is being handled … it is hard to say." He added that "[i]f there are questionable amounts, then obviously, they will err on the side of conservatism."

It is difficult to read this as a strong endorsement of the "clawback" theory, however. Griffin was first asked only about whether a hypothetical decision-maker would "think twice" when evaluating a choice between "two equally well supported claim values,"[43] so there is a considerable gap between (a) his admission that this was possible and (b) any kind of an admission that "thinking twice" would in fact result in a payment that was *not* well supported by virtue of being improperly low. (Paying out on a "well supported claim value" is not obviously an "underpayment," and FEMA specifically declares that the agency will not question "judgment calls" made by adjusters.[44]) As for whether underpayments or overpayments were more undesirable, moreover, Griffin's concession that paying FEMA back out of one's own pocket is less desirable than paying a policyholder additional federal money is not a surprising one. The real question, however, is whether or the degree to which any such arguable imbalance of undesirability actually results in improper decisions.

A third piece of evidence that might seem to support the "clawback" theory comes from an experienced adjuster with one of the major national adjuster companies, who recounts that WYOs are indeed afraid of poor audit results, keen to avoid overpayments, and inclined to remove future business from adjuster companies that create such difficulties. This is only poor support for the "clawback" thesis when it comes to alleged patterns of *underpayment*, however, because this same official insists that very few underpayments actually occur because of the financial incentives adjusters have to maximize claims. (See below.) In his characterization, therefore, adjuster and WYO incentives "even out," with the system pressing toward extremely

---

[43] Nor is it clear how common a situation it is for two different outcomes to be equally well supported – though one experienced adjuster with whom we spoke has indicated that if this *does* occur, it is indeed possible for an adjuster to request guidance from the WYO, or even to engage the services of an experienced GA from FEMA itself.

[44] According to FEMA, "[t]he WYO companies and the NFIP Servicing Agent [on the 'direct' side of the NFIP] rely upon the judgment of adjusters in the preparation of the scope of loss and the estimate of damage. It is natural and expected that the judgment or opinion of the adjuster at the scene immediately after the disaster may differ from those reviewing estimates either on the scene at a later date or by a reviewer in a remote location after the claim has been resolved." While "non-judgmental errors" are said to be not binding upon FEMA, payment of claims by a company in "judgmental matters" *will* be binding upon FEMA. The *Claims Adjuster Manual* describes "[j]udgmental matters where there may be a difference of opinion between WYO claims Management and the Federal Emergency Management Agency (FEMA)" as including such things as "whether a claim payment involved on [sic] excessive, or inadequate, loss payment (*e.g.*, differing views on the amount of depreciation taken, whether a general condition of flooding existed, whether sufficient verification of damages was obtained, etc.)." (By contrast, "non-judgmental matters" are such things as payments made on an ineligible risk, double payments for the same loss, or "payment of a loss in respect to which the damages are unverified.") FEMA, *Claims Adjuster Manual*, *supra*, at II-7.

Indeed, so reticent is FEMA about questioning "judgment calls" made by adjusters in the field that it apparently does not permit even its highly experienced GAs to correct bad "judgment calls" these officials encounter when doing reinspections under the CRP – a point at which correction would be especially useful in keeping estimation errors from occurring in the first place.

low error rates of any kind as underpayment *and* overpayments offset each other.[45] This is certainly no endorsement of the "clawback" theory as an explanation for allegedly pervasive Sandy-related problems, and might even be read as a backhanded endorsement of FEMA's current oversight and accountability methods.

Moreover, there is little evidentiary support for this "clawback" theory. For their part, every WYO and every *other* adjuster with whom we spoke during the course of this review flatly not merely denied the existence of a "lowball" strategy but in fact strongly contested the basic argument that there exists an incentive to underpay at all. (Even FEMA official Brad Kieserman rejected the "clawback" theory when asked about what might perhaps have given rise to the fraud being alleged in the Sandy cases he has been pushing WYOs to settle on plaintiffs' terms.[46]) Indeed, even the public adjuster who had spoken to us about a "fear of clawback" himself conceded that there *also* existed at least some financial incentive for WYOs and adjusters to *overpay* on claims (see below), and emphasized that the *inexperience* of many of the personnel used to inspect damaged properties in Sandy's wake had caused far more problems than any arguable systematic incentives one way or the other.

While it is clear that the WYOs themselves sometimes have to reimburse FEMA for overpayments found during the auditing process, there does not appear to be much evidence of *adjusters* commonly having to cover the cost of such overages. In our discussions with officials from three of the major adjuster companies involved in NFIP work, and with an experienced adjuster who has done NFIP work since 1996, they all recounted it being quite unusual for an adjuster firm or individual adjuster to have to pay back such an overpayment. Some could not recall *ever* having heard of an adjuster being held financially accountable in this fashion, while others remembered some instances but noted that they were "rare."[47]

(1) *Analysis of WYO and DSA Claims Operation Review Data*

To provide some real analytical foundation for an assessment of WYO incentives in such circumstances, therefore, Banking investigators obtained the results of numerous FEMA claims operation reviews for a number of WYO companies – including both major individual WYOs as well as clusters of smaller WYOs that are audited by FEMA as a group – as well as for the DSA. This sample represents claims audit review data for the lion's share of the NFIP's WYO business, since together these WYOs presently manage more than 3.4 million NFIP policies – thus representing three-quarters of the WYO side total of just under 4.5 million, and indeed 65

---

45 His complaint, therefore, is not about any sort of systematic error bias in claims outcomes – which he says does not occur – but rather that the incessant scrutiny of modern claims oversight and accountability places enormous stress on adjusters and makes it harder for them to make a living. With claims files routinely "put under microscopes" and required to contain voluminous documentation, he argues, adjusters are held to "expectations that can't be reached."

46 Kieserman, in fact, said that he had not seen enough evidence to conclude that there had been a pattern of systematic underpayment on Sandy claims, nor to indicate that if there *were* such a pattern it had been due to WYO "incentive structure" reasons. Indeed, in Kieserman's characterization, lawyers for Sandy plaintiffs had "whipped up" the "fear of audits" issue well beyond its merits: he did not believe that WYOs feared audits in the way alleged by this explanatory theory.

47 One adjuster who ran a major adjuster company said that he could remember seeing only eight to 10 instances over the course of his two decades with the NFIP.

percent of the NFIP as a whole – and handled more than 100,000 of the 144,484 claims that arose out of Superstorm Sandy. (Adding DSA reports to this set, moreover, means that we have reviewed claims operation review reports from entities that today handle about 79 percent of the NFIP and that handled nearly 85 percent of Sandy claims.) Notwithstanding the FEMA recordkeeping problems that will be recounted below, we regard this as a good sample of claims operation review reporting for purposes of this analysis.

As described earlier, FEMA's claims operation reviews are carried out on a triennial basis for all WYOs participating in the NFIP, and annually for the DSA, and involve a review by FEMA officials of a random sample of claims files overseen by that particular company. This sample – typically 100 individual claims files, though the number sometimes varies[48] – is reviewed, *inter alia*, in order to determine whether there have been any "critical errors" such as underpayment or overpayment. FEMA tracks the rate at which such errors occur, and requires that any such payment errors found be corrected.

The claims operation review reports reviewed by Banking investigators do not show any consistent pattern of underpayment. They also indicate that on the whole, WYOs' rates of what FEMA terms "critical errors" – and within this category, the rate of specific *payment* errors in particular – is relatively low. In fact, if anything, the data we have seen from claims operation reviews conducted on WYO companies, along with data from the NFIP's Direct side, suggest that there exists a consistent pattern of *overpayment* on flood claims. **Table 1** summarizes this data for each of the claims operation reviews we obtained.

[48] The statistical significance of each sample will vary depending upon the number of claims handled by the WYO in question. For a small company, this FEMA audit sample size may represent most – or even *all* – of its claims during the period under review. For a large player, the number of files will represent a smaller proportion, but is still intended to provide a statistically valid and thus analytically useful sample.

Table 1:
Available Major WYO and DSA Claims Operation Reviews 2003-2014[49]

Carrier	Files Reviewed	Critical Errors[50]	Overpayments[51]	Total overpaid	Underpayments	Total underpaid
WYO side:						
A	79	10 (12.6%)	1 (1.3%)	$29,709.91	None	Zero
B	50	8 (16%)	1 (2%)	$4,193.00	None	Zero
A	50	7 (14%)	None	Zero	None	Zero
C	100	None	None	Zero	None	Zero
B	100	41 (41%)	33 (33%)	$46,022.95	None	Zero
D	100	11 (11%)	5 (5%)	$2,070.81	None	Zero
B	100	17 (17%)	15 (15%)	$23,844.62	None	Zero
C	130	20 (15.4%)	12 (9.2%)	$60,040.28	None	Zero
E	100	8 (8%)	5 (5%)	$2,167.22	None	Zero
F	100	12 (12%)	3 (3%)	$2,089.98	1 (1%)	$934.80
D	100	9 (9%)	4 (4%)	$29,936.59	2 (2%)	$20.50
G	100	5 (5%)	3 (3%)	$7,981.19	None	Zero
B	100	19 (19%)	15 (15%)	$29,895.91	1 (1%)	$548.36
A	100	17 (17%)	12 (12%)	$38,066.83	1 (1%)	$4,000.00
E	100	14 (14%)	12 (12%)	$25,588.14	None	Zero
H	100	None	None	Zero	None	Zero
C	100	20 (20%)	15 (15%)	$271,158.27	None	Zero
I	50	1 (2%)	None	Zero	None	Zero
H	100	5 (5%)	3 (3%)	$3,364.33	None	Zero
J	50	2 (4%)	1 (2%)	$3,086.25	1 (2%)	$398.05
D	100	4 (4%)	2 (2%)	$1,042.41	1 (1%)	NA
J	101	6 (5.9%)	2 (2%)	$5,945.31	None	Zero
G	92	4 (4.3%)	2 (2.2%)	$44,457.47	None	Zero
F	100	3 (3%)	2 (2%)	$2,636.40	None	Zero
B	99	5 (5%)	3 (3%)	$11,223.56	None	Zero
WYO Subtotal						
2,301		248 (10.8%)	151 (6.6%)	$644,521.43	7 (0.3%)	$5,901.71
NFIP Direct side:						
127		16 (12.6%)	6 (4.7%)	$20,598.86	2 (1.6%)	NA
99		8 (8%)	5 (5%)	$16,082.60	1 (1%)	$150.00
79		5 (6.3%)	4 (5.0%)	$12,170.40	None	Zero
78		6 (7.7%)	1 (1.3%)	$4,087.11	None	Zero
100		11 (11%)	10 (10%)	$59,914.66	1 (1%)	$245.52
Direct Subtotal						
483		46 (9.5%)	26 (5.4%)	$103,853.63	4 (0.8%)	$395.52
Total:						
2,784		**294 (11%)**	**177 (6.4%)**	**$748,375.06**	**11 (0.4%)**	**$6,297.23**

[49] Not every report for this period is included, but the ones available span this period.

[50] Not all critical errors are *payment* errors; the sum of over- and underpayments is less than the critical error rate.

[51] Comments appended to one WYO's 2013 audit report recounted that "several claims" had been "significantly over-scoped resulting in an inflated repair estimate and adjuster's expense payment," but that these "may be considered judgment calls on the part of the adjuster, for purposes of this review, and are not being identified specifically as overpaid claims." This suggests that for this company's claims, at least – and potentially for others – the results of the claims operation review reports recounted in this table may *downplay* the extent to which policyholders received unmerited payment windfalls.

These data does not, of course, represent a full survey of results across the NFIP for the dates in question. Nevertheless it is a significant enough sample to produce highly suggestive results.[52] Specifically, it appears that, on the whole, payment error rates of any kind are fairly low – and, intriguingly, that they begin to decline precipitously in claims operation reviews done in 2013 (*i.e.*, that cover Superstorm Sandy) – but that when they *do* occur, policyholders are generally paid *more* money than they are actually owed under their flood policies much more frequently than they are underpaid.

The discrepancy, in fact, is remarkable: in the claims files reviewed by these FEMA audits, an overpayment was found about *16 times* for every underpayment discovered, and the total value of overpayments was perhaps nearly *119 times as much* as the total value of underpayments.[53] To be sure, this claims operation review data may overstate this preponderance of overpayment. Specifically, because such reviews work from the existing documentation provided in the individual claims files selected for review, it is possible that claims operation review data slightly understate the number of actual underpayments made on NFIP policies, since if an adjuster had *completely* failed to record any information about some aspect of possible flood damage, it could be difficult to know what had been omitted simply by looking at the file.

---

[52] In compiling **Table 1**, Banking investigators have attempted to use their judgment in ensuring accurate comparisons over time. For example, in a limited number of instances we corrected claims review figures to account for apparent clerical errors by FEMA (*e.g.*, incorrectly calculating the total amount of overpayments found during a review) or to reflect the final disposition of particular claims cases as indicated in explanatory notes in the FEMA audit records. For this reason, the figures set forth in **Table 1** may not necessarily reflect the numerical figures that appear in the tabular summaries in claims operation review reports.

Table 1, for example, does not count payment errors that the notes appended to the original claims operation review reports indicate were subsequently found by FEMA *not* to be payment errors after further analysis of rebuttal evidence provided by WYO carries, even where the tabular data in these individual reports were for some reason not corrected to reflect these determinations. (For one older report which provided no tabular data but declared that FEMA had made "no findings," moreover, we interpreted this as a determination of no payment errors. In two cases, a report that simply declared that a WYO's results were "satisfactory," however, was omitted from **Table 1** because this provided too little information upon which to base any conclusion about the prevalence of errors at all, let alone payment errors.) We also included data from at least two WYO audit reports that were only labeled as being "drafts" because neither FEMA nor the WYOs in question were able to obtain final copies. (If anything, the final reports would show fewer errors as a result of WYO presentation of applicable rebuttal evidence.)

The total values given in **Table 1** may also slightly underrepresent actual total values, since in cases where payment errors are noted but no dollar amounts were given, we have tabulated critical errors as having occurred but were unable to adjust the total value accordingly. This was not common, but did occur periodically, especially in earlier claims operation review reports.

[53] As can be seen in **Table 1**, the total overpayment value was driven up, in particular, by one WYO's overpayment of $271,297.27. More than half of this amount came from a single $159,478.60 overpayment on a commercial property, however, which had a $500,000 policy limit. (An additional $75,832.46 in overpayment came from a single additional, nonresidential property.) No other overpayment or underpayment of such a magnitude appears in the claims operation review data we obtained, however, so the appearance of this abnormally large overpayment in the files may exaggerate the degree to which total overpayment value outstrips underpayment value. That said, even subtracting these two unusual overpayments, the claims operation review data remain strongly skewed toward aggregate overpayment.

Nevertheless, policyholder concurrence generally is required – in the form of POL documentation – in order for a payment to be made, and this presumably somewhat reduces the likelihood that an adjuster will entirely miss significant damage. Moreover, it is clearly untrue that damage missed by an adjuster necessarily will be invisible to experts who later review the case file: as can be seen in **Table 1**, FEMA claims operation reviews *do* frequently find underpayments. Furthermore, as discussed below, the existence of a preponderance of overpayments is corroborated by data from the 2013 CRP reinspections – in which properties *were* physically revisited, and in which any such complete omissions would be much more likely to be found by the experienced GA sent back to the scene – though the smaller spread of payment error results in CRP data tend to support the supposition that claims operation review findings somewhat overstate the degree by which overpayments exceed underpayments. Nevertheless, we have seen no persuasive reason to question the basic reliability of the claims operation review data, and thus the conclusion that error rates were on the whole low, with overpayments outnumbering underpayments. This finding is quite significant, and undermines the "pattern of underpayment" thesis.

The finding that there does not appear to have been a systematic error bias or any general "pattern of underpayment" across the NFIP, of course, does not mean that there have been no underpayments. Quite to the contrary. As with any catastrophic event, errors are to be expected, and with 144,484 Sandy claims having been made, it would be shocking if no errors had occurred. Moreover, even a low error rate in the processing of Sandy claims would likely equate to a considerable number of policyholders who should have gotten more money. The available evidence, however, does not support the conclusion that underpayments were the result of some kind of mis-aligned incentive structure built into the NFIP.

(2) *Analysis of Sandy Reinspection Data*

Banking investigators also reviewed FEMA's Fiscal Year 2013 CRP data from reinspections on Sandy properties in order to assess whatever error rates and patterns of underpayment or overpayment might have been revealed by reinspections FEMA carried out on Sandy claims in the preparation of its Reinspection Summary Report for 2013 – that is, the period covering Superstorm Sandy. Care must be taken in using these data, but they also fail to support the incentives-based "underpayment" hypothesis. A close reading suggests both that overall error rates were low – especially by comparison to the 20 percent threshold used in claims operation review analysis, and that overall overpayments occurred in at least approximately equal numbers as underpayments, and likely occurred with greater frequency. **Table 2** provides information on underpayments found in the Sandy CRP reinspections.

Table 2: Underpayments in Sandy Reinspections			
WYO	$3,000.00	NFIP Direct	$5,719.44
WYO	$877.29	NFIP Direct	$20,000.00
WYO	$9,000.00	NFIP Direct	$50,000.00
WYO	$1,200.00	NFIP Direct	$14,313.74
WYO	$37,100.00	NFIP Direct	$1,289.29
WYO	$20,000.00	NFIP Direct	$3,100.00
WYO	$834.87	NFIP Direct	$361.48
WYO	$12,243.00	NFIP Direct	$5,500.00
WYO	$40,000.00	NFIP Direct	$128.33
WYO	$2,500.00	NFIP Direct	$351.77
WYO	$6,902.61	NFIP Direct	$756.00
WYO	$700.00	NFIP Direct	$2,089.79
WYO	$1,700.00	NFIP Direct	$789.65
WYO	$4,709.03	NFIP Direct	$502.65
WYO	$8,500.00	NFIP Direct	$1,387.65
WYO	$918.76	Direct Total	
WYO	$5,944.65	15	$106,289.79
WYO	$3,500.00		
WYO	$211.26		
WYO	$10,000.00		
WYO	$1,001.12		
WYO	$1,400.00	**WYO Side:**	
WYO	$2,000.00		
WYO	$10,000.00	88% of Sandy claims but	
WYO	$2,500.00	71% of Sandy's 52 underpayments	
WYO	$1,279.50		
WYO	$5,000.00	**Direct Side:**	
WYO	$3,000.00		
WYO	$5,000.00		
WYO	$1,039.01	11.5% of Sandy claims but	
WYO	$16,000.00	29% of Sandy's 52 underpayments	
WYO	$10,874.09		
WYO	$5,136.51		
WYO	$89.07		
WYO	$989.70		
WYO	$7,641.98		
WYO	$1,150.00		
WYO Total			
37	$243,942.45		

The underpayment data are fairly straightforward: 52 underpayments were identified in the Reinspection Summary Report for 2013 prepared by FEMA's BSA contractor as a result of routine reinspections of 1,877 properties during this Sandy review. Unlike the identification of overpayments (see below), FEMA did not subject this underpayment total to further analysis,

and the final Sandy CRP report identifies all these underpayments as having been "corrected" – that is, corresponding remedial payments had been made to policyholders in question.[54]

Table 3:
Overpayments in 1,877 Sandy Reinspections

Category	Number Found	% of Reinspections
Initially Determined	112	6.0%
Already Repaid or Documented as Proper	65	3.5%
Outstanding as of 2/3/14	47	2.5%
Total Actual Overpayments	> 47	Over 2.5%

The overpayment data, however – the essence of which is recounted in **Table 3** – is more complicated. Care is needed in interpreting the CRP's overpayment findings, because FEMA's data spreadsheet from the 2013 Sandy reinspections in this regard obscures as much information as it conveys. As mentioned earlier, the initial reinspection effort – done in part by adjusters who were *not* regular CRP GAs, but who had been brought in on a temporary basis to help deal with the huge Sandy reinspection caseload – is reported to have done somewhat sloppy work. This resulted in the original Fiscal Year 2013 summary report flagging 165 cases for attention, of which 112 were initially identified as overpayments. In August 2014, when FEMA was first beginning to respond to allegations of problems in Sandy claims management, *actual* GAs were assigned to review the claims files identified in the Sandy report, and they concluded that the actual number of overpayments found was considerably lower.

Precisely how *much* lower the real overpayment figures were, however, is not entirely clear from the data provided by FEMA. It indicates that as of the time the data were compiled in the final Sandy CRP report, some 47 "documented overpayments" existed. A further 65 of the 112 overpayments identified by the GAs in late 2014 were not counted toward the purported final total of 47 because they had by that time been "corrected, or sufficiently documented to be considered proper payments." It was reasonable not to count as overpayments claims which had been discovered in fact *not* to be overpayments through the provision of additional documents. But FEMA's final figures also discounted *actual* overpayments that had been found in these Sandy reinspections wherever these overpayments had already been "corrected" through having been repaid to FEMA by the relevant WYO or the DSA. This decision conveniently minimized the number of overpayments that the final Sandy reinspection report *appeared* to show, since the final total should really have been the abovementioned 47 *plus whatever proportion of the other 65 overpayments had been "corrected" as opposed to "sufficiently documented."* (At the time of writing, FEMA officials apparently still did not actually know what the real number of overpayments was.)

[54] The explanatory note to the spreadsheet that constitutes the final report declares that there were 53 underpayments, but the underlying charts only count 52. We have used this latter figure.

This choice to omit from the final error tally overpayments that had actually been identified but which had simply already been recouped by FEMA by the time the agency began to *reexamine* Sandy claims management in the face of unfavorable publicity is highly distressing. Under FEMA's CRP procedures, if reinspections show an error rate of three percent or greater, the agency must require that "remedial training" occur for the adjusters in question and/or "corrective action plans" be put in place by the relevant WYOs or the DSA. FEMA, however, appears never to have ordered the requisite additional training or the development of such corrective plans, because it – or its BSA contractor, OST, Inc. – declared that "the actual overall error ratio of the 1877 Sandy reinspections is 2.5% and is within the acceptable range … and it is not felt any specific remedial training or corrective action plans are needed, at this time."

This 2.5 percent figure, however, appears to have little basis in reality. As noted, when the final CRP report spreadsheet was compiled, it was decided *not* to count toward the overall error rate overpayments that had already been repaid to FEMA after having been identified in the original 2013 summary report. FEMA also decided not to count toward the overall error rate *any* of the 52 underpayments identified in the course of Sandy reinspections, again on the grounds that these payment errors had already been "corrected" by the issuance of payments to each affected policyholder. By ignoring all payment errors that had indeed occurred but had been "corrected" – that is, by pretending, for these purposes, that a good many of the errors found by its GAs *had not occurred in the first place* – FEMA was able to make the declared error rate *seem* low enough that it fell below the three percent threshold.[55]

In fact, however, counting the 47 outstanding overpayments with the 52 underpayments found by FEMA's GAs, the actual number of real payment errors found was *at least* 99. (The true number is probably higher still, since some of the 65 potential overpayments that were also not counted in FEMA's final calculation were also discounted by virtue of having been "corrected" after having been identified in the summary report.) This means that the real error rate found in the Sandy reinspections was not "2.5 percent" but at least 5.3 percent. This rate, of course, is more than twice the level claimed, and well above the three percent CRP threshold at which FEMA would have had to order "specific remedial training or corrective action plans." As criticism mounted in late 2014 over alleged Sandy claims management problems, in other words, FEMA's handling of this information suggests that the agency did not want its crisis-driven re-evaluation of Sandy reinspections to reveal that FEMA should have known much earlier that some remedial action had been needed.[56]

---

[55] Some window into the perverseness of this methodology can be seen by the fact that according to FEMA's logic, if the BSA had simply delayed drafting the final CRP conclusions until FEMA had brought all payment errors to the attention of the relevant WYO or the DSA and had them duly fixed, FEMA could claim that its reinspections showed a *zero* error rate in Sandy claims processing. It could have claimed this, in fact, even if *every one of the claim files examined* had contained a payment error.

[56] In fact, FEMA officials have told Banking investigators that this kind of skewed methodology was *routine*: in reaching CRP conclusions about whether additional adjuster training or corrective action planning was needed, FEMA has apparently *always* declined to count errors that had been corrected by the time each final report was compiled. It would appear that the conclusions reached on the basis of reinspections have been manipulated for some time, perhaps in order to make it easier to avoid ordering remedial training and to make NFIP management appear better than it really is.

Putting aside this worrying data-gamesmanship, however, we have seen no evidence that the *underlying data* produced by these Sandy reinspections were faulty. (Indeed, the principal problem with FEMA's skewed conclusions is that they *do not* reflect the reality of what the CRP spreadsheets actually contain.) Accordingly, we still believe that the underlying CRP *data* from FEMA's Sandy reinspections provide a valuable window into claims management performance in the NFIP.

Significantly, therefore, the error rate of somewhat higher than 5.3 percent shown in this Sandy CRP data is broadly consistent with the error rates suggested in the available claims operation review reporting we have studied for the 2003-14 period. When adjustment is made for FEMA's gamesmanship in compiling its Sandy CRP reporting, both sets of data appear to show a generally low error rate, and at least a slight predominance of overpayments over underpayments. To be sure, the claims operation review information shows a very great many more overpayments than underpayments, but this is in part due to a higher overpayment rate in earlier reports. The more recent claims operation reviews still show a predominance of overpayments, but not as starkly, and are thus more congruent with Sandy CRP data, which dates from FEMA reinspections undertaken in 2013. (Not unlike the pattern indicated by claims operation reviews – though less dramatically – the aggregate *value* of the overpayments identified in Sandy reinspections also seems to have been notably higher than the aggregate value of underpayments.[57]) In short, the available Sandy reinspection and claims operation review data broadly corroborate each other, tend to show low error rates, and provide no basis for concluding that any sort of "pattern of underpayment" exists.

(3) *Analysis of FEMA IPIA/IPERIA Reporting*

A further window into FEMA's error rates – though, for the reasons below, not always a good one for present purposes – can be found in FEMA's collection of data under IPIA and IPERIA. Under those statutes, and associated guidance from the Office of Management and the Budget (OMB), U.S. Government agencies are required to review their programs in order to identify those which are susceptible to "significant erroneous payments" – defined as annual erroneous payments "exceeding both 2.5 percent of total program payments and $10 million" – to estimate "the annual amount of improper payments in programs and activities," and to report these estimates to OMB.[58] FEMA's IPIA reporting between 2008 and 2013 is given in **Table 4**, as follows:

[57] For the 165 cases initially identified by the Sandy CRP reinspection process as having had payment errors the total value of underpayments is given by FEMA as $350,232.24, whereas overpayments totaled $514,432.31. (This data apparently includes some reinspections done as "special assist" reinspections at WYOs' request, as well as some done in response to requests from Congressional offices.)

[58] *See* OMB, "Issuance of Part III to OMB Circular A-123, Appendix C," M-10-13 (March 22, 2010), at 3-7.

Table 4:
FEMA's IPIA/IPERIA Reports to OMB, 2008-2013

Year	Samples tested	Over-payments	Underpayments
2008	369	41 (11%)	2 (<1%)
2009	301	16 (5%)	None
2010	320	15 (4.7%)	1 (<1%)
2011	328	15 (4.6%)	None
2012	323	3 (<1%)	3 (<1%)
2013	348	None	7 (2%)
Total:			
	1,989	**90 (4.5%)**	**13 (<1%)**

Much caution is needed in interpreting these data, however. Part of this is because FEMA officials have indicated that their first NFIP IPIA/IPERIA report (for 2008) identifies as "improper payments" not just payments *of the wrong amount of money* but also payments where the *right* amount was paid, but in a way that was procedurally improper (*e.g.*, where proof-of-loss waiver documentation was untimely or where a mortgagee was not included in a building payment). FEMA says that its IPIA/IPERIA reporting corrects for "true improper payments for the subsequent years."[59] For purposes of assessing the rate of improper payment amounts, however, the inclusion of merely procedural errors in the 2008 overpayment data makes it difficult to compare that year's figures with the rest of these annual reports.

It must also be remembered that IPIA/IPERIA analysis does *not* use a completely random sample of cases, but rather skews its review sample toward more complex, higher-value claims – which are deemed more likely to contain errors. And indeed, while FEMA works to ensure that the final IPIA/IPERIA result it reports to OMB can be extrapolated across the breadth of NFIP payments, this final result is the rate of improper payments *in terms of dollar value*. The IPIA/IPERIA process aims to extrapolate from sample results to a program-level *amount* of improper payment, in other words, but the methodology is not designed to allow such extrapolation for the *number* of payment errors made.

This creates something of an "apples and oranges" problem for anyone attempting to use IPIA/IPERIA data as a window upon the kind of error rates evaluated in FEMA claims operation review auditing. In the claims operation review process, the *number* of payment errors is the key metric, apparently on the notion that it is important to minimize the number of policyholder claims that are mishandled. By contrast, the IPIA/IPERIA process emphasizes the total *value* of improper payments, so the number of times improper payment has occurred is much less significant than how much money has thereby been involved. FEMA's "improper payments

[59] FEMA officials have explained to Banking investigators that in preparing their IPIA/IPERIA report for 2008 – the first year that such data was compiled – they were greatly overinclusive: putting in "everything and the kitchen sink." Specifically, they counted as "improper payments" all the sorts of things that would count as errors in claims operation reviews. Since not all of these claims operation review errors are actually *payment* errors, however, they revised this methodology for IPIA/IPERIA reports in 2009-13.

percentage" of 0.05 percent reported for the Sandy-inclusive 2013 fiscal year, in other words, represents the conclusion that 0.05 percent of the total value of NFIP payments made that year were likely improper ones.[60] Because of the way the sampling is done, however, it does *not* necessarily follow that the NFIP had a *zero* percent overpayment rate and a two percent underpayment rate in 2013. While FEMA's IPIA/IPERIA data for the NFIP thus indeed seem to suggest commendably small *aggregate value* for improper payments, therefore, one cannot assume that IPIA/IPERIA overpayment and underpayment rates can be extrapolated to the broader universe of NFIP payments.

Even with that caveat, however, it remains striking that even *with* the misleading inflation of overpayment figures in 2008, FEMA's overall error rate across this history of NFIP IPIA/IPERIA reporting amounts to just over five percent – that is, 103 improper payments out of 1,989 samples – and its annual rate has fallen dramatically, to a mere one or two percent in 2012-13. (Because the inclusion of merely procedural errors alongside "true improper payments" in the 2008 data pushed up the total number of apparent overpayments vis-à-vis underpayments, moreover, the true error rate in the IPIA/IPERIA sample was likely lower than suggested by the figures given in the final row of **Table 4**.) For the reasons described above, the error rate is not technically projectable across all NFIP claims, but to the degree that FEMA picks claims for IPIA/IPERIA analysis by pulling larger numbers of files from the higher-value, more complex cases that are felt *most likely* to have errors, these data support the inference that the program's *overall* error rate is indeed probably low, perhaps significantly lower than suggested in the IPIA/IPERIA reports. All in all, it is difficult to contest FEMA officials' contention that IPIA/IPERIA data suggest that the NFIP has been doing fairly well in making accurate payments.

On the whole, therefore, assuming that FEMA's audit processes are indeed conducted as it has been described to us by FEMA officials, multiple WYOs, and claims-management vendors,[61] and that FEMA's file samples are indeed today picked on a random basis,[62] the available audit data from claims reinspections and claims operation reviews suggest that while payment errors do of course sometimes occur, they do *not* occur at a particularly significant rate, and to the extent that they can be said to exhibit *any* pattern of error, *overpayments* seem notably more common than underpayments.[63] (The total *value* of sums found by claims operation reviews to have been overpaid, moreover, seems to be vastly higher.) Nor does it appear that the FEMA audits represent merely whitewash reviews. On their face, they clearly recount the examination of the specific details of individual claims files – *e.g.*, checking their conclusions against the documentary evidence provided therein – and flag the specific nature of the payment errors they bring to WYOs' attention. These highly case-specific details are also subject to discussion with the WYOs or venders involved before FEMA finalizes its report. The notes that

---

60 As a hypothetical example, based on the 2013 results, if there had been $100 in total NFIP disbursements, one would thus expect a program-wide total of $0.05 in improper payments.

61 DHS/OIG is presently reviewing the claims oversight process in order to make sure that FEMA is in fact following its own procedures.

62 As described below, GAO has identified some problems with the randomness of samples in the past, but reports these problems to have been remedied. There was no suggestion that the nonrandom sampling FEMA previously used actually produced results that were biased in any particular direction.

63 FEMA's James Sadler told Banking investigators that claims operation review data over the years show consistent overpayment: "it's always been on the overpayment side."

accompany individual reports often contain remarkably detailed accounts of debates between FEMA officials and WYO or vendor representatives about highly specific matters.[64] On the basis of this evidence, therefore, there is no sign of a pattern of systematic underpayment.

(4) *Other Available Data*

Yet another window into NFIP payment error rates is provided by the report prepared by the auditing firm KPMG for the DHS/OIG in May 2014.[65] This audit selected a sample of claims paid by nine WYOs totaling 450 items, and occurring during three date windows that cover the impact and aftermath of Superstorm Sandy: from October 1, 2012 through March 31, 2013; from April 1, 2013 through June 30, 2013; and from July 1, 2013 through August 31, 2013. Out of the 450 items reviewed, KPMG found only three payment errors – that is, a remarkable rate of only 0.6 percent – of which two were underpayments and one was an overpayment. An additional three claims involved payments being made to policyholders notwithstanding the fact that appropriate POL documentation had not been supplied, arguably making these claims into overpayments as well.

To provide a final perspective upon these issues, we also undertook to assess how the information available to us about Sandy-era NFIP claims performance compares to what little is available from claims re-examination after prior Hurricanes. This comparison was instructive, inasmuch as past remedial reviews of flood claims undertaken by FEMA in response to allegations of widespread problems yielded results broadly consistent with what the available data already show about Sandy.

Seven months after Hurricane Isabel, for instance, FEMA established a "Task Force" to re-examine claims related to that storm, pursuant to which all of the nearly 24,000 Isabel policyholders were given the opportunity to have their claims re-examined. Some 2,294 claimants opted to undergo this re-examination, and in the resulting scrub of their cases, about 460 were found to be owed additional money because their original estimates had omitted some covered flood damage.[66] Given how unrepresentative of the full Isabel caseload the Task Force's 2,294 respondents are likely to have been – since policyholders who were overpaid, or were simply *satisfied* with their NFIP payments, are surely less likely to have elected for this re-

---

[64] The level of detailed debate between FEMA and WYOs over the details of apparent payment errors varies considerably, but there are numerous examples of highly specific discussions having occurred. In one case, for example, an adjuster's "administrative charge" was discounted, resulting in a WYO overpayment of $5.00, while in other cases the discussion centered on such things as: precisely how many inches of flood water there had been in a playroom; whether a type of watercolor paper listed by an adjuster was sold in pads as opposed to sheets; whether coverage should include a toilet and bathtub broken by contractors in the course of making repairs; whether a pair of work boots could be replaced without documentation of to whom they actually belonged; whether waves strong enough to break a set of stairs were also strong enough to wash out sand from beneath a structure; and the degree to which several inches of water seepage wicked up into adjacent drywall and insulation, and how much of this should be covered given that FEMA had not set a clear standard for how much fiberglass insulation to replace in such circumstances. In one case, irrespective of the factual detail in the file, FEMA even recorded a complaint against an adjuster's use of terminology that "lacked professionalism."

[65] DHS/OIG, *National Flood Insurance Programs Management Letter for FY2013 DHS Financial Statements Audit* (OIG-14-92) (May 5, 2014).

[66] *See* GAO, "Improvements Needed in National Flood Insurance Program's Financial Controls and Oversight," *supra*, at 28-30.

examination – this approximately 20 percent rate of overlooked flood damage seems fairly low, and would presumably extrapolate to only a fairly small underpayment rate across the universe of nearly 24,000 Isabel claims.

After Hurricane Katrina, FEMA also set up "a special task force of adjusters and supervisors" to reinspect 1,696 expedited claims from Katrina. (This was in addition to the reinspections conducted in FEMA's regular CRP process.) This group found an error rate of approximately five percent. GAO has cautioned that this error rate might not extrapolate to Katrina claims more broadly because FEMA used nonrandom selection methods for these reinspections, but GAO's *own*, random-sample study of Katrina and Rita reinspections still found very low overall payment error rates. In fact, though a larger number did not meet NFIP standards in other ways, only about one percent of expedited reinspections for Hurricanes Katrina and Rita that were reviewed by GAO were determined to have been overpayments. For Katrina reinspections handled using regular (non-expedited) procedures, the underpayment rate was found to be three percent and the overpayment rate 11 percent, while for regular Rita reinspections the error rate was two percent, consisting entirely of overpayments.[67]

All of these findings are generally consistent with the low error rates suggested by claims operation reviews, Sandy reinspection data, and IPIA/IPERIA reporting. Based on all the available information, therefore, there seems to be no empirical basis to support any theory pursuant to which audit-based financial incentives drove WYOs – or any other NFIP participant – into a systematic practice of flood claims underpayment in order to avoid having to pay FEMA back for overages.

[67] GAO, "National Flood Insurance Program: New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved," GAO-07-169 (December 2006), at 54-56.

B. *WYO and Adjuster Compensation Structure*

Key Points:

WYO participants in the NFIP make more money as the total amount of claims paid out to their policyholders increases. This gives WYOs a financial stake in maximizing claims paid.

The adjusters who estimate flood damage in the field – and the adjuster companies whose staff examiners review field reporting – also have an incentive to maximize claims value, because they are paid pursuant to an NFIP Fee Schedule that pays them more on larger claims than on smaller ones.

It is theoretically possible for an adjuster to make more money by rushing to complete multiple claims than by thoroughly completing a smaller number, and this could perhaps result in flood damage being missed, leading to underpayment. It is also possible, however, for such haste to result in *too much* damage being claimed – producing an *overpayment* – making its net impact unclear. Adjusters are also generally unable to receive any payment if the policyholder has not concurred in the damage estimate, which may also make at least major omissions less likely.

There is no evidence to support the hypothesis that engineers working in the NFIP reflexively downplay flood damage because that is what they are accustomed to doing in other insurance lines.

Whatever incentives may or may not exist for WYOs, it is notable that the Direct side of the NFIP – where there *are* no WYOs – exhibits the same pattern of claims problems as the WYO side. This suggests that WYO incentives play no role in generating such problems.

Complicating the picture further, the current structure of the NFIP creates an arguable incentive for WYOs and adjusters to *overpay* on flood claims. This notion – almost universally acknowledged by the WYOs and adjusters with whom we spoke, though they all denied that any such incentive had actually driven them to reach inaccurate conclusions – is based upon the fact that both WYOs and adjusters make more money as more money is paid to policyholders.

In addition to other fees they collect from FEMA on the basis of written premiums,[68] the WYOs participating in the NFIP are compensated, in part, as a percentage of claims paid,

[68] According to FEMA, WYOs get 30.9 percent of the written value of premiums, which includes a 2.3 percent allowance to pay state sales tax, 15 percent for agents' commissions, and 13.6 percent for internal administrative and operating expenses. Additional money is given to the WYOs to cover various handling expenses: about 4.5 percent to cover adjuster expenses (Allocated Loss Adjustment Expenses [ALAE]), 1.0 percent for consultation with experts such as architects or engineers (Special Allocated Loss Adjustment Expense [SALAE]), and about 2.5 percent for other expenses associated with claims handling (Unallocated Loss Adjustment Expenses [ULAE]).

receiving 1.5 percent[69] of the total money paid out to holders of "their" flood policies.[70] If FEMA paid $2 million on one WYO's claims volume, for example, it would also pay that company $30,000 as a fee for serving as a pass-through for federal flood money. (This 1.5 percent fee resulted in a total of $58.5 million being paid to participating WYOs for the $3.9 billion that had been paid by FEMA to policyholders for Sandy flood claims by October 2014.[71]) The fact that this aspect of WYO compensation is determined on a percentage-of-claims basis means that WYOs are paid more by FEMA as more money is paid out in flood claims: the larger the claim payment, the larger the WYO fee,

Similarly, adjusters are paid pursuant to the NFIP Fee Schedule promulgated by FEMA, and pursuant to which their fee increases as the amount of flood damage increases.[72] Under the version of this Fee Schedule specified for losses occurring on or after October 25, 2012, for instance, FEMA would pay $490 for adjuster services on an individual flood claim that was found to total only $1,000, but would pay the same adjuster $1,640 on a flood claim that totaled $36,000.[73] Here, too, the greater the dollar value of claims paid, the greater the compensation for adjusters. This seems to be well understood by all participants, having been mentioned to Banking investigators by most interview subjects. According to James Sadler, the former head of FIMA's Claims and Appeals Branch, for instance, it was clear for the WYOs and adjusters that, "the more you pay, the more you get paid." In the words of one adjuster, "a big loss pays good."[74]

In other words, this percentage-based compensation system gives both WYOs and adjusters[75] some financial incentive to find as much flood damage as they can. As one flood

---

69 This 1.5 percent is part of the 2.5 percent for ULAE mentioned in the previous footnote, the rest of that figure coming from a ULAE assessment of 0.9 percent of written premium.

70 The flood policies, it should be recalled, are not *really* those of the WYOs, though policyholders may believe this because the WYOs market, sell, and handle such policies *for* FEMA, and correspond with policyholders on corporate letterhead. In fact, the terms of the policies are set by the NFIP, the rules of the system are set by statute and by FEMA, and all claims paid come out of government funds.

71 *See* FEMA, "Hurricane Sandy: After two years, $13.6 billion, FEMA continues N.Y. recovery," Release no. SRO-011 (October 23, 2014), *available at* https://www.fema.gov/news-release/2014/10/23/hurricane-sandy-after-two-years-136-billion-fema-continues-ny-recovery.

72 Adjuster companies and individual field adjusters commonly split the fee set by this document for each claim, with the company typically taking a 30 percent share and the adjuster getting the balance. (In the event that the fieldwork involves adjusters working as a mentor/mentee pairing, a typical split seems to give 30 percent to the company, 60 percent to the field adjuster, and 10 percent to the mentor overseeing the work of the field adjuster.)

73 *See* FEMA, "NFIP Adjuster Fee Schedule – 2012 Revision," W-12084 (November 2, 2012), *available at* https://www.nfipservices.com/DesktopDefault.aspx?tabindex=5&tabid=35. The figures were slightly different for losses occurring after September 1, 2004, but the same point holds. *See* FEMA, "NFIP Adjuster Fee Schedule," *available at* https://www.fema.gov/media-library/assets/documents/12530.

74 FEMA has at least once stressed – in a claims operation review report – the need for examiners to "challenge information provided by the adjuster, *i.e.* the amount of depreciation taken on items that require it and provide documentation of unit cost items that appear excessive or that are questionable."

75 Too little information is presently available to assess the potential impact of the compensation scheme for third-party administrators (TPAs) hired by WYOs – or by FEMA on the NFIP's Direct side – to manage claims cases, largely because TPAs regard such terms as proprietary. These companies are paid pursuant to the specific contractual terms they happen to have negotiated, and these terms may vary considerably. FEMA officials have told Banking investigators that TPA compensation is typically given as some percentage of written premiums,

inspection engineer put it, both "the adjuster and the insurance company have an interest in paying as much as possible." Representatives of multiple major adjuster companies agreed, noting that "we [adjusters] get paid on the gross" and therefore "adjusters want to pay everything they can," "want to see damages from a selfish standpoint," and wish to "pay the most we legally can."

As with the original "fear of clawback" argument itself, of course, merely to identify the existence of this apparent financial incentive to overpay is not to demonstrate that WYOs and adjusters actually *acted* on it to produce skewed flood damage analysis, and no one with whom we spoke made any such admission. Nevertheless, the compensation structure for WYOs and for adjusters provides a counter-narrative of arguable *overpayment* incentives that points in a different direction from the "fear of clawback" argument for *underpayment* based on the handling of critical errors found in FEMA claims operation reviews and claims reinspections.[76]

C. *"Running and Gunning" Allegations*

The same public adjuster who articulated the "fear of clawback" argument also advanced a different contention, this time related not to WYOs but instead to the practical incentives facing adjusters in the field. In his description, especially in the wake of a major flood event such as Superstorm Sandy, adjusters face financial incentives to work more quickly than accurately. Specifically, he said, they face incentives to adopt an approach he called "running and gunning," whereby an adjuster aims to work rapidly through as many separate claims as possible rather than spending the time to assess them more accurately. He conceded that it was true that adjusters made more money *from any single claim* as the value of the flood damage found in that particular claim increased. He nonetheless contended that it was still to an adjuster's advantage to rush through multiple claims superficially rather than to take the time carefully to assess them on an individual basis in order to maximize the per-claim flood damage that is found while significantly reducing the risk of "over-scoping" the loss.

Whether, and the degree to which, the "running and gunning" argument holds true is likely to be a fact-specific question, the answer to which will vary according to the severity of the flood event, including, among other things, the number and monetary value of the claims at issue. A simple analysis of the NFIP Fee Schedule for adjusters, however, does indicate that it is

---

but may also provide additional money based upon either the number of claims handled, the value of claims paid, or both.

To the extent that TPAs make more money according to the *number* of claims paid they might have some incentive to rush through claims cases more quickly in order to inflate the total; to the extent that they make money according to the *value* of claims paid, they would have some reason to inflate claim size. Whether any such arguable incentives exist will depend upon their contracts, and whether these incentives push in the direction of either underpayment or overpayment is not clear *a priori*. Conceivably, a TPA that makes more money according to both metrics would have an incentive to rush through claims quickly *by overpaying them*. FEMA has told Banking investigators that vendor compensation to NFS, the DSA contractor handling all policies on the Direct side of the flood insurance program, is paid on the basis of the number of each type of policy serviced.

[76] WYOs frequently allege that the "reputational damage" caused by perceptions of underpayment and litigation over flood claims is harmful to customer and agent relations in their other lines of insurance. If such a broader reputational and "whole of business" worry exists among WYOs who also do non-flood work, it would likely create some incentive against underpayment.

possible to imagine circumstances in which an adjuster would indeed do better, in financial terms, by rushing incompletely through claims rather than thoroughly studying them.

Imagine, for instance, that an adjuster faced a choice between (a) carefully and completely assessing the flood damage on Property X during a certain period of time and (b) rapidly assessing flood damage there in order to rush on to adjust claims at Properties Y and Z with equal haste. Assuming that the flood damage at each property is $9,000, but that an overhasty assessment would find only $5,000 of this easily identifiable damage, the adjuster clearly has incentives to choose Option (b). Under the current NFIP Fee Schedule, he could earn a $970 fee from fully studying Property X alone, finding all the $9,000 worth of flood damage there and being paid accordingly, but this compares poorly to rushing through all three properties by finding only $5,000 in each case – which would earn him a smaller fee of $750 *per property*, but net him a total of $2,250.[77] Moreover, by choosing option (b), the adjuster reduces the chances of "over-scoping" the loss. Mathematics of this sort could perhaps create an adjuster incentive to engage in "running and gunning."[78]

To the degree that incompleteness of an adjuster's analysis led to some aspects of flood damage being overlooked, therefore – as is expressly assumed in the hypothetical example above, for which it was posited that hasty analysis of a property would find only $5,000 in damage but more comprehensive study would reveal $9,000 – "running and gunning" could indeed result in underpayment on the claims involved. That said, however, it may be a mistake to assume that incomplete analysis by an adjuster seeking to maximize his profits by "running and gunning" necessarily results in the systematic *under*-estimation of flood damage.

It is also possible, however, that hastiness could result in the *overestimation* of flood damage – such as, for example, if the perceived need for speed made an adjuster overly credulous in evaluating policyholder claims that all of the property's problems had been caused by floodwaters. Interestingly, one engineer with whom we spoke has specifically suggested this possibility, at least with respect to engineers, recalling that "some guys" during the aftermath of Superstorm Sandy would, in effect, file reports saying little more than: "I came, I saw, it was all caused by flood. Sincerely, Engineer." If adjusters took an analogous approach – and indeed they would seem to have far more incentive to do so, since engineers only get paid by the hour whereas for an adjuster, as we have seen, "a big loss pays good"[79] – "running and gunning" could certainly lead to the systematic *overestimation* of flood claims.

One adjuster with two decades' of experience in the NFIP told Banking investigators, in fact, that when staff examiners at adjuster companies such as his own review field reports, it is

---

77 "NFIP Adjuster Fee Schedule – 2012 Revision," *supra*.

78 It is also possible that adjusters feel some pressure from above to move quickly. Adjuster firms tend to monitor the length of time that adjusters take to handle cases, for example, and FEMA at one point even conducted a "for cause" audit of one WYO after becoming concerned that the WYO in question was taking too long. This is not necessarily out of any desire to shortchange policyholders, of course. As noted in the Recommendations section of this Report, after a major flood event such as Sandy, huge numbers of policyholders may desperately await flood damage payments, and there may be good reason to move quickly.

79 Because adjuster fees are calculated on a percentage-of-claims basis, a "run and gun" approach that involved quickly *highballing* individual claims before rushing on to additional cases would make an adjuster even more money than a strategy of hastily lowballing them.

not uncommon for mistakes to be found that point in *both* directions: an adjuster who is rushed or sloppy sometimes indeed misses an item of covered damage, but he may also have mistakenly identified something else as being covered flood damage. Sometimes, he said, the errors cancel out.[80] This is supported by FEMA's findings in a claims operation review covering Direct side claims during the period of Superstorm Sandy, in which it was noted that "[a] considerable number" of claims apparently handled by inexperienced adjusters made overpayments *as well as* underpayments, with the result that "the errors financially offset." There does not seem to be any necessary correlation between sloppiness and underpayment.

On balance, it is thus difficult to say, *a priori*, whether "running and gunning" would lead to underestimation or overestimation. This is yet another potential incentive structure that may have played a role in Sandy, but even if "running and gunning" occurred in anything other than an isolated and idiosyncratic way – a thesis which is difficult to sustain in the face of audit review and reinspection data, and for which even the public adjuster who raised the notion was not able to provide Banking investigators with any clear evidence[81] – its impact is analytically indeterminate. It is also worth mentioning that two experienced adjusters with whom we spoke both emphatically denied that "running and gunning" was a sustainable strategy. They each claimed that their respective companies' casefile tracking would quickly identify field adjusters who were rushing through cases without taking all the requisite steps, and that these adjusters could face penalties such as the withdrawal of some claims assignments or even termination. In addition, these experts contended, any supposed incentive to pass over flood damage in order to move along over-hastily to the next property would generally be counterbalanced by the need to secure the policyholder's *agreement* with a damage estimate – through the mechanism of proof-of-loss documentation – before a claim, and therefore also the adjuster himself, could get paid. They did not deny the possibility that some adjusters might *try* to "run and gun," but they felt such instances to be "rare" and argued against this being a plausible locus for systematic problems.

---

[80] In fact, Banking investigators reviewing claims operation review data from one WYO found a case in which this actually happened: a review of the claims file indicated that an underpayment had been made on some damage, but other information in the file showed *overpayment* on some other aspect of the case. In that instance, the two errors largely canceled each other, though the overpayment was slightly larger than the underpayment. In another case with the same WYO, two errors largely canceled each other, but resulted in a net underpayment. (In the tabular data reproduced in this Report, the former case is recorded as a [net] overpayment and the latter as a [net] underpayment.) In a third instance with a different WYO, a supplemental payment that was found to be owed offset a separate overpayment on the same file that had been found, resulting in no net payment error. Finally, in another report, errors found in two files partially canceled each other, resulting in smaller net overpayments.

[81] In fact, this adjuster did not ultimately seem to think that "running and gunning" was *inherently* a major problem. He understood the need for claims to be handled as quickly as possible in the wake of a major flood event in order to minimize the delays faced by policyholders in getting claims serviced. He made clear, however, that whatever the reason for an adjustment error – *e.g.*, whether it arose out an adjuster's rush to reduce the hardship caused to policyholders by delay, out of "running and gunning" in order to maximize fees, or for some other reason entirely – the NFIP must have a way in which to take a "second look" at claims where needed, and to take appropriate corrective action.

D. *The "Engineering Autopilot" Hypothesis*

One additional hypothesis that has been advanced as to why Sandy claims may generally have been systematically "lowballed" involves not financial incentives but rather the *instincts* or *habits* of engineers called upon to assess structural damage to flooded properties, especially less experienced engineers hastily pressed into service to handle the spike in claims caseload caused by the storm. This idea, which was suggested to Banking investigators not only by one adjuster with whom we spoke but in fact also by FEMA official Brad Kieserman, speculates that field engineers doing structural damage assessments in effect *misunderstood* the WYOs' incentives in such a way that they assumed the NFIP to operate like "normal" insurance, in which the insurance companies who ultimately employ such engineers allegedly prefer to *minimize* findings of covered damage so as to reduce the payouts that are made to policyholders with corporate funds.

This assumption of insurance "normality" is unfounded, both because claims made under the heavily-subsidized insurance policies of the NFIP are paid with money provided out of FEMA accounts, and because the participating insurance companies, as we have seen, actually make *more* money if higher claims are paid. Nevertheless, this argument goes, inexperienced engineers who understand the flood program poorly may reflexively apply to flood claims a "standard operating procedure" of damage minimization they learned elsewhere. By this "autopilot" hypothesis, in other words, such engineers' *confusion* about the real financial incentives facing their ultimate employers – the WYO insurance companies – drives them to lowball flood claims out of an incorrect assumption that this is what the insurers want.

It is true that Banking investigators have heard anecdotal accounts of how some engineering companies scrambling to handle the enormous spike in claims associated with Superstorm Sandy supposedly simply used – as one engineer told Banking investigators – "warm bodies for engineers just to get [claims] moving" or, as one WYO company said, "anyone with a license." (In fact, this WYO company had heard of a case in which an *electrical* engineer had been used to assess structural damage in the wake of Superstorm Sandy.) Such inexperienced engineers might well have known little or nothing about the NFIP, and might conceivably have incorrectly assumed both that insurance companies in the flood arena pay claims as they do elsewhere and that such employers therefore would be happier if field engineers were to downplay flood damage.

The evidence for such an inadvertent but effectively systematic engineering bias, however, is very weak. To begin with, the theory depends upon the assumption that the *non-flood* insurance world is, in effect, rife with fraud by engineers who deliberately downplay structural damage in order to protect the insurance companies who employ them. Even proponents of the "engineering bias" thesis have yet to produce evidence to support this sweeping and provocative claim.

Even accepting that tendentious claim *arguendo*, however, the evidence for an engineering bias seems very weak. As we have seen, the actual FEMA audit data from random samplings of claims files undertaken as part of the claims operation reviews and data from FEMA's post-Sandy CRP reinspections in 2013 do not suggest the existence of a pattern of

"lowballing" in the first place. (If anything, as noted earlier, the contrary is true: audit data tends to show more overpayments than underpayments.)

Additionally, the "engineering autopilot" hypothesis suffers from a basic structural flaw. The loudest claims of alleged fraud associated with Sandy claims processing have to do with claims that engineering reports prepared by field engineers were *altered* by the engineering companies who reviewed such reports before passing them along to adjusting companies, third-party claims management vendors, and ultimately the relevant WYOs. It is these purported alterations by engineering *companies* to downplay flood damage, it has been alleged, that represent the locus of fraud in what have been called the Sandy "suspect engineering cases."

The conceptual problem with the "engineering autopilot" hypothesis, however – even though it has been advanced specifically in an attempt to explain these Sandy engineering cases – is that its explanation for alleged lowballing lies precisely in the assumption that field engineers who *misunderstand* the flood program are likely to apply (non-flood) "standard operating procedures" in reflexively seeking to minimize flood damage. If it is inexperienced field engineers who lowball claims on the basis of such reflexes, however, then "peer review" by supervisory personnel in the engineering companies – who *do* understand the NFIP incentive structure well – would presumably tend to *correct* lowballing by allowing the application of proper flood expertise that the field engineers lack.

If it is assumed that engineers would wish to advance the financial interests of the companies that ultimately employ them, even though these engineers' own compensation is entirely independent of claim size, savvy supervisory engineers doing "peer review" in the engineering companies might even wish to turn things around by erring on the *high* side. Unlike the field engineers, after all – many of whom may have been temporarily recruited from non-flood careers simply in order to handle the Sandy caseload – the reviewing engineers presumably *do* know the NFIP well, and thus understand that higher claims make the WYOs and adjusting companies more money (and thereby potentially happier repeat employers for the engineering companies). The "engineering autopilot" theory – in which field engineers allegedly *found* flood damage only to have these findings pared back by engineering company reviewers – thus seems inconsistent with the facts it is usually advanced to explain.

It should be re-emphasized, of course, that Banking investigators have not had access to the case files specifically at issue, and all the evidence that has been adduced, in the ongoing Sandy lawsuits in New York and New Jersey. Accordingly, we cannot rule out fraudulent alteration of some sort by engineering companies in any particular case. It is difficult, however, to identify any sort of general, monetary incentive structure or approach that would be sufficient to drive engineering companies to orchestrate such systematic fraud. At the very least, on the basis of the information currently available, the "engineering autopilot" explanation appears to be inadequate.

E. *Direct Side versus WYO Side in Litigation*

As described earlier, a sizeable portion of the NFIP is not managed through WYO companies at all, but consists instead of policies managed directly by FEMA. As a consequence,

an examination of the effectiveness of claims management on this Direct side of the NFIP can provide an important analytical point of comparison to help shed light on the role of the WYOs, if any, in the alleged NFIP claims problems that have received such media attention.

Specifically, if such claims problems result in some fashion from misbehavior or misaligned incentives by the WYOs – as is sometimes alleged – then one would expect no such difficulties to occur on the Direct side, where there *are* no WYOs. By contrast, if the same sorts of problems seem to be occurring on *both* sides of the flood program, they would therefore *not* seem to be the "fault" of the WYOs or the role such companies play in the NFIP. Instead, these problems would be more likely to result from incentives facing *other*, non-WYO players (*e.g.*, the third-party vendors, adjusters, and engineers with whom even FEMA contracts in order to handle claims cases), or simply to stem from the fundamental challenges of managing *any* sort of flood insurance program effectively in the wake of something as catastrophic as Superstorm Sandy.

It is of some note, therefore, that the WYO side and the Direct side do not seem to differ significantly in their litigation "pickup rate": the proportion of claims that have given rise to lawsuits. To be specific, out of the 144,484 Sandy claims cases, FEMA data show that the Direct side of the program had 16,640 cases, of which 140 were in litigation – a "pickup rate" of 0.8 percent. As set forth in **Table 5** below, according to data provided by FEMA, this puts the NFIP Direct side in good company, but not in anything like a class of its own by comparison to most of the WYOs with Sandy claims, whose "pickup rates" range from a low of 0.2 percent to as high as 1.9 percent.

Table 5:
Superstorm Sandy Litigation Pickup

Carrier	Sandy Claims [out of 144,484]	Sandy Cases in Litigation [out of 2,043]	Litigation as % of Sandy claims
Middlesex Mutual	1,247 (0.9%)	2 (0.1%)	0.2%
USAA	3,688 (2.5%)	10 (0.5%)	0.3%
NFIP Direct	**16,640 (11.5%)**	**140 (6.9%)**	**0.8%**
Harleysville	6,753 (4.7%)	80 (3.9%)	1.2%
New Jersey Reinsurance	4,738 (3.3%)	59 (2.8%)	1.2%
The Hartford	11,070 (7.6%)	146 (7.1%)	1.3%
Nationwide	5,045 (3.5%)	66 (3.2%)	1.3%
Wright Flood	21,124 (14.6%)	307 (15.0%)	1.5%
Assurant (American Bankers)	9,533 (6.6%)	144 (7.0%)	1.5%
New Hampshire	549 (0.4%)	8 (0.4%)	1.5%
Selective	19,337 (13.4%)	316 (15.4%)	1.6%
Travelers (Standard)	18,368 (12.7%)	296 (14.5%)	1.6%
Metropolitan	929 (0.6%)	15 (0.7%)	1.6%
Philadelphia Indemnity	529 (0.4%)	10 (0.5%)	1.9%
Allstate	17,208 (11.9%)	328 (16.0%)	1.9%
TOTAL SAMPLE	**136,758 (94.7%)**	**1,926 (94.3%)**	**1.3% (average)**

By these metrics, at least, the presence or absence of WYO involvement thus seems to have little or no relationship to the degree to which disputes have arisen in Sandy claims management.

This point is, in fact, readily conceded by FEMA officials. FEMA Deputy Associate Administrator for Insurance Brad Kieserman, for instance, acknowledged to Banking investigators that the number of cases in litigation for each side of the program (as well as the number of "engineering cases" among such lawsuits) was indeed proportional to the overall policy volume handled by each prong of the NFIP. Whether a claim occurred on the Direct or the WYO side, he said, made essentially no difference to its likelihood of ending up in Sandy litigation. In fact, Kieserman admitted that if the whole NFIP had been run as the Direct side was run up to and through Sandy, it would have made no difference. Both sides of the NFIP experienced Sandy-related problems at the same rate *whether or not WYOs were involved*. All this makes it very hard to argue that the WYOs were in any significant way "the problem" in connection with Sandy claims management.

F. *Litigation Problems*

Key Points:

Many problems have been alleged with how NFIP claims cases are handled in court:

- WYOs are generally the defendants in claims litigation and make case management decisions, but litigation costs are paid by FEMA, arguably creating some disincentive to settle.
- WYOs suffer the reputational risks of defending claims cases, but in fact have remarkably little ability to control the claims outcomes given the extremely attenuated chain of control from the carriers down through multiple layers of independent contractors.
- Policyholder plaintiffs have difficulty ending up with what they are owed under their NFIP policies, since their attorneys' fees have to come out of NFIP flood payments.
- Some WYOs may believe that their fiduciary relationship with FEMA precludes or might penalize compromise case settlements, and FEMA has not provided adequate clarification on this point.

On the whole, litigation is a poor mechanism for handling flood claims problems, making it especially important that the NFIP's internal appeals and dispute-resolution processes be robust and effective.

Most of the analysis in this Report attempts to understand the NFIP from the perspective of how to improve it in order to minimize problems of claims assessment and payment. This review has *not* particularly focused upon questions of how claims *lawsuits* are handled. It is worth noting, however, that controversy has arisen not just over the merits of specific court cases but in fact over the claims litigation process as a whole. As various participants have recounted them to Banking investigators, these problems have several aspects.

First, though FEMA pays the litigation costs of defending claims cases in court, it is the WYOs – whose money is not on the line – that generally make case-management decisions because it is these WYOs who are the named defendants in NFIP claims cases. (WYOs generally employ outside counsel to do the work of actually defending cases, with in-house attorneys making overall case-management decisions. Reimbursement for hourly billings by defense counsel is paid by FEMA.) This allegedly reduces WYOs' incentives to settle cases and encourages protracted litigation, because the *cost* of such litigation is not borne by the parties (*i.e.*, the WYOs) making the decisions. A further factor that may encourage the prolongation of claims case defense is the fact that plaintiff's outright victory in court does not usually entail a payment of attorneys' fees by the losing defendant, whereas a compromise settlement might indeed include some such payments.[82] This, too, may make protracted litigation more attractive, from a WYO's perspective, relative to the idea of reaching a settlement.[83]

---

[82] FEMA Deputy Associate Administrator for Insurance Brad Kieserman complained repeatedly to Banking investigators about this problem of alleged WYO litigation incentives, arguing not only that FEMA has to pay the bills for defense costs without having control over defense strategy, but also that case dispositions in NFIP cases seldom pay plaintiffs' attorney fees. (An exception to this, Kieserman said, is when plaintiffs succeed in lawsuits brought under the Equal Access to Justice Act [EAJA], 28 U.S.C. § 2412).

[83] It should be noted that WYOs strongly deny that such factors influence their case-management decisions, arguing that the reputational damage they would face – and the resulting problems for the *non*-flood insurance coverage that makes up, in some cases, 99 percent of their business – gives them powerful reasons to avoid being seen as intransigently litigious when sued by their own customers.

The degree that such "who pays" factors actually *do* influence WYO decisions remains unclear, although the claim of FEMA-funded WYO stubbornness was advanced by FEMA's Brad Kieserman in his conversations with Banking investigators. Kieserman has expressed disdain for WYO attorneys – whom he has described as being "emotionally involved" in claims litigation to such an extent that they are "not rational" – and professes to be able to understand the WYO's legal situation in Sandy litigation much better than they do. Getting ahead of both the course of this litigation and the actual evidence adduced therein, Kieserman also told Banking investigators that pretrial discovery in New York has demonstrated that the engineering company U.S. Forensic (USF) committed fraud in handling Sandy claims. In particular, he pointed to a so-called "template" document apparently produced by that company for engineers working on flood claims, which Kieserman said shows clearly that USF trained its engineers to dismiss structural flood damage as a matter of routine. This review has not explored specific allegations of fraud in specific Sandy cases, and certainly cannot rule out that Kieserman was correct that fraud almost certainly occurred in USF cases.

The import of the so-called "template" document, however, is unclear. It certainly *does* seem to contain pre-written sections that declare that the property in question was *not* structurally damaged by floodwaters. On the other hand, in its paragraphs providing explanatory detail, the document offers damage-dismissing language under the heading "only if *not* flood damage," while *also* providing a description of how floodwaters *can* indeed cause structural damage and offering the engineer a spot in which to insert a description of "conditions observed and which of the 4 floodwater forces caused them." (This latter opportunity is to be used "only if there *was* floodwater damage.") Other sections of the document contain text providing highly specific measurements (*e.g.*, "the north exterior wall leaned outward approximately 0.25 inches ... [and] the east and west exterior walls … leaned inward up to approximately 0.375 inches") that seem much more likely to represent *illustrative* text than any sort of directions to find *those specific measurements*. U.S. Forensic, "Building Damage Evaluation" template (undated), litigation discovery document stamp 3PBAIJ000522, at 1 & 5-7 (emphasis added). It is not obvious on the face of the USF "template" exactly how it was used or what impact, if any, it had on the findings of any particular engineering report. It did not appear to Banking investigators, however, that Kieserman in fact understood the factual and legal issues of the New York and New Jersey litigation better than the attorneys involved.

Because plaintiff's litigation costs are not usually paid separately in such lawsuits, moreover, NFIP policyholder plaintiffs must often pay their attorneys' fees out of the money awarded them under their flood policies. As a result, a policyholder's success in obtaining legal redress in claims litigation can sometimes come at the cost of actually ending up with all of what he was owed when he wins the case with the assistance of his attorney, though any such effect would still presumably be preferable to not having brought suit in the first place. Such dynamics may have some impact in shaping decisions in claims litigation.

Some WYO attorneys have argued that the structure of the NFIP may discourage settling cases through mediation or some other form of compromise settlement in an additional way. According to some WYO attorneys, it is technically *impermissible* for a carrier to settle a case by "splitting the difference" on a disputed amount. Because the WYOs have a fiduciary relationship with FEMA with regard to how to spend FEMA funds, this argument goes, they are not allowed to agree to settlements that provide either more or less than what a policyholder is actually owed.[84] It has also been suggested that if any such settled case happened to be randomly selected for FEMA's CRP or claims operation review auditing, it might be deemed a payment error, thus counting towards a company's "critical error" rate.[85]

In discussions with Banking investigators, FEMA officials Brad Kieserman, James Sadler, and Jordan Fried disputed this interpretation, though they concede that they have never actually issued public interpretive guidance making clear their position on this point.[86] Nevertheless, even by FEMA's account, this WYO description is not wholly wrong. It may be the case that settlements in excess of amounts technically owed are indeed permissible,[87] but Fried and other FEMA officials have confirmed to Banking investigators that claims operation reviews *do not* exclude settled cases, and that it was possible that such a case might indeed initially show up as a payment error by virtue of the difference between the amount paid to the policyholder (pursuant to settlement) and the amount technically owed. If the claims file made clear that this had been a case settled out of litigation, however, the information would be forwarded to FEMA attorneys for review. If, in their judgment, the settlement payment in question was "unreasonable," the claim would remain a critical error in the audit report and be subject to any applicable recoupment of overpayment. Fried could not recall this ever happening, but he conceded that it was theoretically possible that a settled case could be held against a WYO as a repayment-triggering critical error as much as three years afterwards.[88]

---

84 *See, e.g.,* William Treas, Memorandum "Re: July 30, 2014, CLE Training of Mediators and Arbitrators" (July 23, 2014), at 3-4, *reproduced in* Charles Lane, "Why Sandy Homeowners Were Left in the Lurch," *WNYC News* (May 14, 2015), *available at* http://www.wnyc.org/story/why-sandy-homeowners-were-left-lurch/.

85 Lane, *supra* (reporting that FEMA staffers "confirmed that the agency would undertake audits even on settlements reached through mediations").

86 Jordan Fried has indicated, however, that FEMA *has* communicated this position in guidance given to WYO attorneys.

87 FEMA attorneys appear to refer to this as settling for "litigation value" – which may exceed the amount owed under a policyholder's NFIP policy as the price of making costly litigation go away.

88 Fried observed, however, that WYOs could protect themselves against this eventuality by seeking FEMA approval of all settlements in advance, though FEMA did not require this. FEMA approval at the time of settlement would serve as a "safe harbor" if a payment in a settled case were ever challenged thereafter in the auditing process.

Accordingly, this may still be a factor that makes settlement at least slightly more challenging in the NFIP context than it might be elsewhere in the world of insurance claims disputes.[89]

Nor is it entirely clear why WYOs are the named defendants in NFIP claims cases in the first place, given the highly attenuated networks of control and claims management oversight over which they preside and, as noted above, the fact that they do not pay out of pocket to defend flood insurance lawsuits. To say the least, for example, it is not intuitively obvious why WYOs should be generally held responsible for alleged problems created by independent contractors (engineers) hired by independent contractors (engineering companies) brought in at the recommendation of independent contractors (adjusters) hired by independent contractors (adjusting companies) hired by the independent contractors (third-party vendors) that have been retained by WYOs in order to handle claims processing.

Especially since Hurricane Katrina – after which some WYOs were sharply criticized for alleged conflicts of interest because their adjusters had been deciding whether property damage was the result of wind (for which the WYOs would have to pay) or flood (for which FEMA would pay) – the NFIP has been characterized by long and deliberately nebulous chains of command running from WYOs down through multiple layers of independent contractors to the persons who actually visit properties and make determinations of flood causation and damage. After Hurricane Katrina, Banking investigators have been told, FEMA in effect encouraged this shift away from a model wherein WYOs could exert meaningful control over flood assessments in the field.

Even though FEMA officially certifies whether individual adjusters are flood-qualified personnel suitable for adjusting flood claims, we are told by the very contractors FEMA employs to train adjusters that the agency refuses to offer adjusters any training in *how to do* flood damage adjusting. Instead, lest the agency be accused of promoting any particular adjusting methodology, FEMA confines itself to training adjusters simply in *what* NFIP policies cover. In fact, FEMA's James Sadler has expressed dislike for the term "flood certified" because, in his opinion, it creates a false impression that FEMA "signs off" on adjuster qualifications and expertise. In reality, according to FEMA, all matters of actually how to do flood adjusting are deliberately left essentially entirely to the professional discretion of the adjuster companies themselves. With so much apparent effort having been put, over the years, into *minimizing* WYOs' control over adjustments in the field – and, indeed, with FEMA itself adopting an essentially identical vendor-discretion-dependent organizational model as it has run the Direct side of the NFIP – it is not entirely clear that WYOs are the appropriate default defendants in flood claims litigation.

In its own politicized efforts to make bad publicity from ongoing Sandy claims litigation go away, moreover, FEMA has apparently also tried to cut corners at the very edge of propriety

---

[89] It is also worth noting that while the Biggert-Waters flood insurance reform legislation of 2012 did provide for the possibility of FEMA participation in nonbinding, state-facilitated mediation of flood claims, it only provides for "settl[ing] claims … in amounts *up to the limits of policies under such [national flood insurance] program.*" Biggert-Waters National Flood Insurance Reform Act of 2012 (Title II of the ''Moving Ahead for Progress in the 21st Century Act," H.R. 4348, 112th Congress, 2nd Session (June 28, 2012), at § 100223 (modifying Chapter I of the National Flood Insurance Act of 1968 [42 U.S.C. §§ 4011 *et seq*.]) (emphasis added).

or beyond. In March 2015, for instance, FEMA official Brad Kieserman negotiated with plaintiff's counsel Steven Mostyn without involving the WYOs who are actually the defendants in the Sandy claims cases, proposing to use FEMA money to pay Mostyn a sizeable fee – 25 percent of the value of all claims paid – in a way that was subsequently declared unlawful by the Office of General Counsel at the Department of Homeland Security. More recently, Kieserman has pressured WYOs to settle these Sandy cases on a blanket basis, irrespective of their merits, by cooperating with Mostyn to threaten the insurance companies with the possibility that – abandoning FEMA's usual practice by means of an *ad hoc* and admittedly unprecedented "reinterpretation" of NFIP rules – FEMA would refuse to pay WYO litigation costs in defending Racketeer Influenced and Corrupt Organizations (RICO) Act cases that Kieserman said Mostyn would likely bring if the WYOs refused to pay Mostyn's 25 percent contingency fee out of their own corporate pockets. (Kieserman's threat seems to have been instrumental in eliciting at least some WYOs to settle a number of the "suspect engineering cases" in May 2015.)[90]

The structure through which NFIP claims are brought and adjudicated in court thus seems itself to be highly unsatisfactory in multiple ways. While these litigation issues were not a particular focus of this review, therefore, we believe that these problems deserve further attention, for the current process is clearly flawed. In fact, even senior FEMA officials such as Jordan Fried concede that litigation is a poor vehicle for the resolution of flood claims disputes, since the process is cumbersome and expensive and the generally small amounts of money involved seldom make it worthwhile for policyholders to pursue cases. At the very least, an awareness of these litigation-related problems illustrates the importance of improving the means by which the NFIP ensures accuracy and efficacy in claims adjusting and payment, in order to minimize the extent to which cases slip through the cracks of the system – and its various error-correction mechanisms – and *need* to go to court in the first place. It is to the subject of NFIP improvements that this Report will turn in its final sections, but first it is necessary to provide a sort of "net assessment" of the structural and systematic incentives we have explored in the previous several pages.

[90] Kieserman appears to have thus helped Mostyn threaten WYOs with possible RICO liability notwithstanding the fact that Kieserman himself told Banking investigators that he does *not* believe there was any legal ground for such liability. (Kieserman, for instance, declared that there is no basis for having Sandy lessons-learned assessments "be about beating up on the WYOs.")

G. *A Net Assessment of Systemic Incentives*

Key Points:

The available information does not support the hypothesis that financial incentives both support and have resulted in a consistent pattern of claims underpayment. Theories of systematic underpayment based upon WYO or adjuster fears of having to repay overpayments are poorly supported and inconsistent with available data.

Theories of engineer bias based on habits acquired in other lines of insurance are not consistent with the available evidence, inconsistent with the role and compensation of engineers within the NFIP, and based upon an unsupported assumption that all *other* insurance is rife with engineering fraud.

The most plausible "theory of the case" for explaining difficulties in Sandy claims management is simply that the scale of that storm overwhelmed the NFIP's supply of high-quality adjusters and engineers, almost inevitably and unavoidably resulting in problems.

To summarize, therefore, a review of the information to date fails to reveal any clear set of general incentives or pressures within the NFIP that would provide a plausible explanation for the systematic problems that have been alleged to exist in Sandy flood claims.

(1) *Weakness of the WYO "Lowball" Hypothesis*

The "incentive-to-underpay" argument is not supported by claims operation review or CRP data, which fail to indicate a consistent pattern of lowballing, and show generally low error rates in the first place. The assumption of that hypothesis that WYOs somehow act to control the disposition of damage assessments in the field, moreover, is weakened further by the fact that WYO compensation is in fact *higher* as claims increase, thus giving these companies, if anything, an arguable countervailing incentive to *overestimate* claims. Moreover, as set forth in Tables 1 and 2, data from claims operation reviews show a general tendency toward overpayment that is slightly more pronounced on the WYO side than the Direct side,[91] while data from FEMA's 2013 reinspections suggest that during Sandy, at least, the Direct side clearly *underpaid policyholders more frequently* than did the WYOs. (Direct side policies made up only about 12 percent of the NFIP's 144,484 Sandy claims, but they accounted for nearly *30 percent* of the underpayments found in the Sandy CRP review.)[92] These sources do not,

[91] It is apparently not unheard of for a WYO to act on its own to pay a policyholder even where the need for such a payment has not been firmly established. In an example from one WYO's audit review, after "rounding and coinsurance calculation errors resulted in an underpayment," the WYO is recorded as having made "a business decision in concert with their agent in order to make the insured whole although the amount of applicable coverage did not meet the coinsurance requirement."

[92] Conceivably, the Direct side is more averse to overpayment than the WYO side. In evaluating DSA claims operation review reports, Banking investigators found one instance in which an adjuster was sent back to the property in question after FEMA auditing had identified an overpayment. This second visit resulted in the identification of additional flood damage that canceled out the overpayment amount. FEMA complained,

therefore, seem to show a pattern of underpayment that is in need of explanation in the first place.

In addition, the attenuated chain of command between WYOs and the adjusters and engineers who actually do the work of assessing flood damage in the field also cuts against the "lowball" theory. Specifically, it is difficult to imagine a mechanism by which a mysteriously underpayment-minded WYO would be *able* systematically to direct the creation of skewed outcomes across a variety of individual adjusters and engineers, even if it wished to do so.[93]

The "fear of clawback" argument might be more plausible if applied not to WYOs but to third-party vendors or adjuster companies, since as lower-level intermediaries in the process, they are much closer to the operational decisions that get made in the field. Even with them, however, it is hard to defend a strong theory of underpayment incentives, given that their own compensation – the vendors pursuant to contractual relationships with the WYOs, and the adjusters pursuant to a FEMA Fee Schedule – also tends to increase with higher claims payouts. (It also seems to be relatively uncommon, though it remains possible, for adjuster firms or individual adjusters to be forced to recoup overpayments.) All in all, therefore, the "incentive to underpay" thesis seems analytically weak, undercut both by the indeterminacy of its basic incentive assumption and by the lack of a clear mechanism by which underpayment-minded participants could act effectively on any such incentive by distorting assessments made on the scene.

(2) *Weakness of the "Engineer Autopilot" Hypothesis*

Putting aside compensation-based incentives, it is conceivable – as described above – that as the NFIP claims management process scrambled to provide post-Sandy manpower needs and unusual numbers of *inexperienced* engineers were pressed into service, these engineers reflexively downplayed flood damages pursuant to some kind of "standard operating procedure" they had learned in non-flood contexts. As a generalized explanation for Sandy problems, however, this hypothesis is also weak even if one accepts its remarkable and unwarranted assumption that engineering fraud is the default mode of the non-flood insurance world. This is so not only because FEMA's claims operation review and CRP data fail to reveal such a pattern of systematic lowballing, but also because the most publicized allegations of "engineering fraud" in Sandy litigation have concerned claims of alterations of field engineering reports by engineering *companies* – that is, by experienced supervisory engineers who presumably *did* know the flood program well, and whose job was precisely to error-review the work of their less-experienced colleagues in the field. Whatever reasons such supervisory cadres within the engineering companies might have felt to change field assessments, it seems extremely unlikely that *they* suffered from ignorance of the NFIP's WYO and adjuster compensation structure and

---

however, that it was wrong to "back into a supplemental estimate after FEMA review to remove a critical error and overpayment."

[93] This factor also cuts against any theory whereby a WYO might aim systematically to *overpay*. In theory, because a WYO's exposure to overpayment "clawback" is limited to the relatively small number of case files subjected to claims operation reviews but WYOs get a percentage of *total* claims paid, it might be possible for a WYO to make more money by systematically *overpaying* at an error rate just below that which would trigger additional FEMA audits. We do not draw this conclusion, however, because under the NFIP's diffuse system of management controls, such a fine degree of operational influence over field decisions seems extremely unlikely.

automatically followed any "standard operating procedures" that engineers might be argued to follow outside the NFIP. Accordingly, the "engineering autopilot" hypothesis does not seem to have strong explanatory value.

(3) *So is there any "Theory of the Case" for Sandy?*

Accordingly, the currently available information about the structure and operation of the NFIP fails to support any theory of systematic, monodirectional error bias. We certainly cannot exclude the possibility of error in any particular case – and, in fact, given the number of claims and the reported shortages of experienced manpower associated with Superstorm Sandy, it would be shocking if there *weren't* a good many errors – nor can we exclude the possibility of some kind of actual misconduct or fraud in some cases. Nevertheless, there seems to be little evidence of, or an underlying logical basis for, any sort of systematic upward or downward error or bias within the NFIP regarding the determination of flood damages.

To the extent that the information adduced in this review points toward any more general theory of Sandy-related claims errors, it does so in a non-conspiratorial and much more prosaic way. By the account of essentially *every* interview subject with whom we have spoken, the NFIP was simply not prepared for the magnitude of the flood-claims crisis it faced when Superstorm Sandy smashed ashore along the most heavily-populated coastline in the Americas. Experienced adjusters involved in these events, for instance, recounted that "there wasn't enough of anything to go around at the time," including adjusters and engineers, and that some found it "overwhelming" and "couldn't handle it." With individual adjuster caseloads spiraling upwards – sometimes to figures far above the number to which adjuster firms told Banking investigators they normally try to limit their personnel for quality control reasons[94] – it was all but inevitable that problems would occur. In short, however well the claims process might have worked in "baseline" years, there were too many claimants, too few adjusters, and too few engineers available to handle claims in the aftermath of Sandy without significant problems.

Under these circumstances, it is not difficult to imagine hasty analysis, rushed assessments, inexperienced personnel, and caseload time pressures taking their toll on claims accuracy. Making things worse, most participants we interviewed also described a considerable degree of policyholder confusion about what their own flood policies actually covered in the first place, particularly with regard to the NFIP's exclusion of coverage for earth movement even when caused by flood waters. This confusion, coupled with the inherent complexity and sometimes counter-intuitive provisions of NFIP coverage, exacerbated the challenges involved even in entirely unhurried and *accurate* flood damage adjustment. In this combination of circumstances, it would not be surprising for many policyholders to have felt ill-treated by the NFIP, and a good number in fact to have been so.

---

[94] There is some discrepancy in how adjusters reckon their caseload – *e.g.*, whether their figures represent the total number of cases they ended up handling over the course of responding to Superstorm Sandy, or simply the peak number they had to juggle *at any one time* – but our interviews with adjusters made clear that this was a major challenge. One adjuster company said that it succeeded in keeping its adjuster's load to an average of 40 claims each, with perhaps some 25-30 active files at any one time. Another said it kept its adjusters to a limit of about 100 files, but had heard of at least one adjuster having to manage 180. One very experienced adjuster recounted 50-60 claims as being a normal maximum, but said that he himself had had to manage 140 over the course of the Sandy response.

The most obviously plausible "theory of the case," therefore, is simply the commonsense answer that it is difficult for federal bureaucracies and complex public-private partnerships to be prepared for, and to function well in, extraordinary crises. When a "super-event" like Sandy occurs, there will inevitably be problems, and quite possibly a great many of them.[95] The following pages will examine the management challenges that our review has identified in the NFIP, with an eye to making recommendations about how the program can minimize or recover from the unavoidable errors that are likely to occur under such circumstances.

[95] Interestingly, although he was a tireless advocate of WYOs settling Sandy cases and had initially told Banking investigators that he was convinced that widespread fraud *had* occurred in the "suspect engineering cases," FEMA's Deputy Associate Administrator for Insurance Brad Kieserman expressed to Banking investigators his belief in late May 2015 that there probably *was no* "smoking gun" in the Sandy claims cases. What problems there had been, he said, probably stemmed from an NFIP management system that was too "disconnected" – and FEMA "interventions" over time that had been too "weak" – to manage the errors that were inevitable in a major event such as Sandy. Kieserman declared that all one could really do was "design and build for the catastrophic, knowing that it will always exceed [your] capacity."

IV. *NFIP Claims Process Management Challenges*

Key Points:

On both the WYO and the Direct sides of the program, claims management is highly diffuse and attenuated, involving complex chains of contractors and making detailed control by FEMA or the WYOs difficult if not impossible. The program is highly reliant upon the independent judgment of field personnel.

Given this reliance, and given the system's vulnerability to becoming overwhelmed by a huge event such as Sandy, it is essential that the NFIP have robust and reliable internal mechanisms for error prevention, error correction, and dispute resolution.

FEMA's claims operation review and reinspection programs appear to provide fairly good *post hoc* quality control, though the CRP offers less of a real-time error *prevention* mechanism than it was originally intended to provide, and FEMA appears to have failed to use CRP data, as it claims to do, as a means of identifying when additional adjuster training or corrective action plans are necessary.

After a major storm event, there are strong reasons to begin processing as many claims as possible as quickly as possible, perhaps even at some cost to individual claims accuracy. If this is done, however, it is essential that the NFIP have a strong process for identifying payment errors, allowing policyholders to make claims for supplemental payment, and appealing denials of coverage.

There are many problems with FEMA's internal appeals process, most of all in its troubling structure as a process in which FEMA refuses to order that appropriate payments to be made even when it *agrees* with a policyholder on appeal, and in which FEMA does nothing to track whether such payments have occurred. (FEMA has now adopted a special, separate mandatory process for Sandy victims but has left flood victims in Kentucky, Texas, and elsewhere subject to its merely hortatory, regular procedures.)

Most of the NFIP management challenges identified in this review will already be apparent from the account set forth in the preceding pages, but they are worth summarizing here in order to highlight their thematic unity. They all relate to the difficulty of preparing the program for resilience, error-minimization, and error-correction in the face of outsize catastrophes that are, by definition, beyond what the program's personnel and procedures are able to handle by "business as usual."

A. *Diffuse Control and Accountability*

One of the facts that may be most striking to a newcomer to NFIP issues is the extremely attenuated system of ostensible "chain of command" relationships within the program. It may appear to the policyholder that the WYO insurance companies play the leading role in the system, for these institutions are the ones from which ordinary people purchase NFIP policies, to which they turn for redress when a flood occurs, and the names of which appear on the checks

ultimately issued in order to cover flood damage. It would be natural to assume that the entire chain of claims processing activity is closely managed and overseen by the WYOs.

In most cases, however, this is far from the case. Within the framework of rules set by statute, FEMA provides overall direction and interpretive guidance for the flood program, while the WYOs serve principally as "pass-through" organizations. The people a policyholder actually meets in the course of the claims process have a deliberately indirect relationship with the WYO, and the trickle-down character of these relationships can be rather bewildering. As described earlier, an engineer doing a structural damage causation assessment on the scene will most likely be an independent contractor who has been employed by an engineering company that has itself been engaged at the recommendation of an adjuster who was serving as an independent contractor for an adjusting company that is serving as an independent contractor for a third-party vendor that itself serves as an independent contractor for the WYO. The engineering company, in turn, is also likely to be an independent contractor for the third-party vendor, or to be working for an adjusting company that is itself an independent contractor working for the vendor.

The Direct side of FEMA's business – where the government sells and oversees flood policy management without the intervening layer of WYO involvement – involves a very similar level of organizational complexity. Here, too, the chain of control runs down through multiple layers of contractors. It is commonly said that FEMA runs the Direct side of the flood program "directly," but this is not strictly true: it has hired the company NFS to manage claims as the Direct Servicing Agent. NFS, in turn, contracts with adjusting and engineering companies exactly as vendors hired by WYOs do on the WYO side of the NFIP.

Not even FEMA, in other words, runs flood claims without hiring independent contractors in the form of specialist third-party vendors and the associated network of adjuster- and engineering-services contractors described above. Even on the Direct side," the NFIP relies hugely on the expertise and judgment of individual claims adjusters and engineers in the field, and upon the intermediate cadres of vendors who manage them. FEMA is today relying heavily upon contractors even to assess how well its legions of direct and indirect contractors performed in response to Sandy, and to remedy any problems found in these regards. FEMA's current "Sandy Task Force," charged with reevaluating potentially *all* Sandy claims cases, is staffed at least in part by personnel from contract vendors such as the major adjuster companies.

Ultimately, in fact, there may be no way to do otherwise. FEMA official Brad Kieserman estimated that it takes about a million people to administer the NFIP effectively, and contended that it would be impossible for FEMA to run the program without contractors. Short of creating a large, rigid, unwieldy, and extremely expensive federalized army of bureaucratic functionaries, in other words – a remedy that would be far from likely to improve performance in a Sandy-like crisis but which would impose significant additional costs and management challenges in times both fair and foul – this does appear indeed to be the case: there is no way around having to rely upon contractor specialists. The challenge for the NFIP, then, is to manage them better.

B. *Error-Correction*

Because there is no way around reliance upon sizeable cadres of contract specialists, it is essential that the flood program retain a robust claims file auditing process. Hence the workability and fairness of the NFIP's claims management process depends hugely upon the integrity of FEMA's process for auditing claims files. In this regard, FEMA's Brad Kieserman criticized the FEMA claims operation review process for being too *weak*, and before leaving FEMA advocated making such audits more frequent and extensive. On the other hand, most public criticism of FEMA and the WYOs in connection with Sandy claims has implied, in effect, that these audits are, if anything, *too* effective. (Accusations of a "pattern of underpayment" rooted in WYO incentives to avoid having overpayments caught and "clawed back" by FEMA rely upon the assumption that WYOs fear triennial audits to the point of obsession and assume that overpayment errors *will* be caught reliably by such reviews.) The truth may be somewhere in the middle. While statisticians might perhaps debate the merits of reviewing a sample of 100 claims files every three years as the principal means of assessing the performance of any single WYO, however – or of reviewing a single 100-file sample each year for the entire 735,963-policy Direct side of the NFIP – our review did not find evidence of systematic problems with FEMA's audit and reinspection programs, except only insofar as FEMA appears not to have fully or properly *used* all the data these programs make available as tools to inform its management of the program.[96]

To be sure, GAO found several years ago that neither FEMA's method of selecting file samples in the CRP nor its file selection from claims operation reviews was fully random.[97] Both FEMA and GAO officials have reported to us, however, that these statistical-sampling problems as having been remedied. The audit process would presumably also provide at least a

---

[96] As noted below, FEMA's recordkeeping is very poor, and it has neglected to do, or to require its BSA contractor to do, the kind of trend-tracking analytical work that seems essential for NFIP management. As described in a footnote above, moreover, FEMA has proven unwilling to use its own reinspection data as a tool for identifying when additional adjuster training or corrective action is required in the program – even to the point of apparently deliberately obscuring its own reinspection data in order to make such remedial steps seem less necessary.

[97] The CRP was criticized by GAO for also using "judgmental criteria including, among other items, the size and location of loss and complexity of claims." Government Accountability Office, Report to Congress, "National Flood Insurance Program: New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved," GAO-07-169 (December 2006), at 7. GAO also found that "FEMA did not use a statistical sampling methodology to select files for operational reviews," instead employing "nonprobability sampling processes" in which "staff … select a sample based on their knowledge of the population's characteristics." This limited, GAO said, the ability to extrapolate claims operation review data to a larger population of claims cases. GAO, Report to Congress, "National Flood Insurance Program: Improvements Needed in National Flood Insurance Program's Financial Controls and Oversight," GAO-10-66 (December 2009), at 17.

Internal FEMA documents suggest that some officials with the BSA had called for statistically random CRP sampling as early as 1994. As of at least April of that year, for instance, it seems to have been understood that "[t]here was no set or absolute standard" in place for casefile sampling. Rita Peacock, "Reinspection Percentage," Memorandum to Thomas Hayes" (April 20, 1994). By the end of 1994, in response to a review by the Inspector General, an NFIP actuary had recommended to FEMA's Insurance Examiner that the CRP begin using statistically valid, binomial sampling procedures. Thomas Hayes, "Claims Reinspection Program," memorandum to Bonnie Shepard (December 2, 1994). If GAO's findings are correct, however, this was not actually fully instituted until more than a decade later.

somewhat better window upon claims practice if the WYOs' notionally triennial claims operation review were actually conducted every three years rather than merely at each point three years after *the close-out of the previous review*. But this is a comparatively minor criticism.

Though some WYO companies did suggest that improvements were needed in permitting them to appeal FEMA audit findings and in FEMA's provision of clear guidance about what actually counts as a "critical error" in such reviews, no interview subject with whom we spoke during the course of this review identified any significant problems with FEMA's claims operation review process. To all appearances, therefore, the claims operation review process and the more event-specific CRP do appear to be valuable tools that can permit FEMA not only to identify and to correct errors in the particular cases reviewed, but – more importantly – to track WYO, DSA, and overall NFIP performance and trends over time. These programs seem to select a meaningful sample of files for review, examine them in detail, not infrequently find both overpayments and underpayments, ensure the correction of any such critical errors, and hold WYOs and the DSA responsible for controlling error rates.[98]

Apart from FEMA's abovementioned failure adequately to *use* or even consistently to *retain* the data that these programs make available to it, therefore, this review has not identified significant problems with the existing audit system with regard to their mechanism of *post hoc* spot-checking in order to ensure generally low levels of claims adjusting error. In addition, the CRP – through which FEMA uses experienced GAs to conduct spot-checks, as it were, of claims handled in the course of a federally-declared flood disaster – was also given fairly high marks, at least with regard to the competence and professionalism of the GAs. Other adjusters with whom we spoke seemed to find GAs to be experienced and creditable professionals, and to do good work.[99] The relatively low error rates found during CRP reviews, moreover, generally corresponded to those found in the claims operation reviews, with the result that these data sets may be treated as largely corroborating each other. At the time of writing, therefore, there is little reason to believe that the various existing claims review mechanisms are particularly problematic – though, as will be discussed further below, FEMA needs to do much better at

---

98 FEMA's Kieserman complained to Banking investigators that there are too many WYOs participating in the NFIP, suggesting that it is difficult for FEMA to exercise meaningful oversight over so many players and speculating that it would work better if there were only "three or four" major participants. At least as the FEMA claims audit process currently works, however, the multiplicity of WYOs probably ensures that a much greater proportion of claims files are actually subject to audit review than would be the case if the NFIP were managed through only three or four players. At present, each WYO is subject to a FEMA claims operation review of randomly-selected claims files every three years. With 80-odd WYOs participating in the flood program, therefore, quite a few 100-file audits occur every year on the WYO side of the program – fewer than on the Direct side of the NFIP, where FEMA's contractor NFS apparently faces only one claims operation review annually. Under existing procedures, therefore, the number of files actually reviewed would be much lower if the flood program contained only a handful of WYOs. If the WYO side of the NFIP came to be dominated by a much smaller number of participants, of course, FEMA might be expected to increase the frequency of its claims operation reviews – or their sample size, or both – but the point remains that there is little data suggesting at present that WYO numbers *per se* are a problem in terms of claims administration, especially in the context of Superstorm Sandy. This issue of WYO participation is discussed further in the Recommendations section of this Report)

99 We heard mixed reviews of the *auxiliary* personnel hired to support General Adjusters in doing Sandy reinspections, but not of the GAs themselves – who were, in fact, ultimately used to review and correct the work of the supplemental cadre in question before FEMA finalized its 2013 Sandy CRP report.

keeping, aggregating, and analyzing the data these audits produce, and using such information to spot emerging issues and track trends over time.

In assessing the adequacy of existing claims operation review and CRP auditing procedures, it will be instructive to compare the results of Sandy-era audits with whatever comes out of FEMA's current Sandy re-evaluation process – which at the time of writing is still ongoing. Caution should be used in comparing the rates at which Sandy re-evaluations provide additional payments and the payment error rates shown in claims operation review and CRP data, however, for at least two reasons. The Sandy claims being subjected to re-analysis are not randomly selected from across the universe of 144,484 Sandy cases but instead are self-selected by policyholders who have been given the option of participating in this process.[100] As a consequence, the Sandy claims that end up being re-evaluated might well be resolved in policyholders' favor at a higher rate than would a random sample of Sandy claims. The rate at which additional payments are made in the current Sandy review could thus be higher than the underpayment rates indicated in claims operation review and CRP data without invalidating those audits as a general means by which to identify errors and assess error rates in the NFIP's claims management process. Nevertheless, FEMA's current Sandy review will likely be a useful reference point in overall program oversight.[101]

One potentially important way in which the NFIP today *lacks* an oversight mechanism that it once had, however, concerns the CRP's shift into becoming the kind of error-correction process it is today. According to FEMA's James Sadler, the CRP was originally designed to serve a very different purpose: it aimed to rush experienced GAs into the field immediately after a federally-declared flood event in order to help "nip [ongoing adjusting problems] in the bud." These spot-inspections of ongoing work seem to have been premised upon the hope that where characteristic problems begin to develop with how adjusters approach damage estimation in the wake of a major flood, the CRP GAs in the field will be likely to spot it and direct that appropriate remedial steps be taken.

---

[100] There has also been some suggestion that the FEMA's Sandy review is *principally* to identify underpayments. While it is true that FEMA has advised policyholders that "[this] review may result in a determination that you previously received an overpayment," the purpose of the effort is explicitly to give Sandy policyholders a chance to have FEMA "review the claim to determine if you may be eligible for an additional payment … [a]lthough underpayments did not occur in every case." Brad J. Kieserman, "Dear Policyholder" letter regarding "Hurricane Sandy Flood insurance Claims Review" (undated).

[101] The outcome of the ongoing settlement negotiations in Sandy *litigation* is likely to be less useful as a comparison point, however, for three reasons. First, these cases are more likely to be unrepresentative of the broader Sandy claims landscape even than the cases currently being self-selected by policyholders for reevaluation. Second, FEMA officials have indicated to Banking investigators that they plan to be unusually lenient, in evidentiary terms, in Sandy case settlement: rejecting out of hand engineering reports prepared by several specified engineering firms and accepting in their place reports written by engineers paid by the plaintiffs. Third, FEMA officials have also said that they anticipate settling some Sandy lawsuits for "litigation value" – a term, as noted earlier, that denotes an amount informed by the anticipated costs and risks of litigation and therefore is often in excess of actual claim value. (According to FEMA, the average Sandy claim size currently in litigation is about $93,800, but at the time of writing the average Sandy *settlement* size was $111,000.) As a result, it will be very difficult to reach any conclusions about overall Sandy underpayment or other errors rates or values from looking at the outcome of these settlements.

Over time, however, the CRP was changed from being a process devoted to on-the-scene, immediate error prevention to one devoted instead to *post hoc* error correction. Today, therefore, the CRP is essentially a separate and additional mechanism for accomplishing claims file spot-checking analogous to that which occurs in claims operation reviews. As noted, this seems to be a valuable mechanism, but the NFIP has largely *lost* the ability to send GAs to the field in the immediate aftermath of a flood event in order to help correct problems long before they might be found by after-the-fact, spot-checks of claims files.

C. *Handling Sudden Manpower Demands*

What clearly does not work so well, however, is the NFIP's approach to "surging" manpower into the work of claims adjusting and engineering inspections after a major flood event. The number of experienced and capable adjusters and engineers available for such work during "normal" times in any particular area of the country – or even in the country as a whole – was apparently quite inadequate in the face of the challenge presented by Superstorm Sandy, and we heard numerous stories about the problems that arose as inexperienced personnel struggled to handle an enormous caseload in a short period of time.

To some extent, of course, this "Super-Event Problem" is unavoidable, for it would surely be entirely infeasible, in organizational and financial terms, to build the NFIP's "baseline" field-assessment infrastructure around the manpower and resource needs of something as catastrophic as Sandy. Given that some improvisational "surge" will still be needed in extreme events, the NFIP's management focus should therefore be upon how to limit and manage the nature and scale of the problems that will inevitably occur despite everyone's best efforts.

In crisis circumstances, moreover, there may be sound policy reasons to move through the assessment of policyholder claims as quickly as possible, so as to ensure that those owed money for flood damage get a chance to begin rebuilding their lives as quickly as possible by being given at least *some* initial payment under their NFIP policy. In this sense, therefore, it might be quite reasonable for FEMA – and the various diverse participants who in some sense work for that agency in administering claims under the NFIP – to prize being "fast" in the assessment of any particular claim over being painstakingly "complete." To the extent that speed is indeed achieved at the potential cost of completeness, however, the system will also need to have in place a robust error-correction mechanism, so that individual damage assessments can be revised or supplemented as more information or better analysis becomes available.

D. *Dispute Resolution*

Since this sort of error-correction is a matter of providing opportunities for new information to be introduced – *e.g.*, if some covered damage or additional repair cost becomes apparent later – and not just of ensuring that the information *already* in claims files is properly understood and acted upon, FEMA's process of *post hoc* review of randomly-selected claims cases through triennial audits is not enough. NFIP policyholders deserve a more robust and accountable system for bringing supplemental information to the fore, for disputing damage or

cost assessments, and for handling claims appeals short of the cumbersome remedy of claims litigation.

It is not, of course, that the NFIP *lacks* procedures for filing supplemental claims or disputing denials of coverage. Banking investigators' discussions of these issues with FEMA officials and with staff attorneys and a former adjuster working *pro bono* with a law clinic specializing in Superstorm Sandy claims, however, suggests that these various appeals procedures – short of actual litigation – do not work as well as they should.

We have heard complaints, for instance, that the appeals process is dysfunctional, and that the allegedly very low percentages of appeals that succeed – on the order of eight percent, according to staff attorneys with one Sandy claims legal clinic,[102] or 15 percent by the estimation of FEMA official Brad Kieserman – effectively discourages policyholders from appealing and *encourages* litigation. In itself, of course, a low success rate for claimants in the appeals process is not necessarily a problem. If the system were to produce accurate damage estimations, for instance, the success rate on appeal *should* be low, because there would be few errors to correct. On the other hand, a low success rate on appeal in a highly error-prone system would suggest that the review process is also flawed.

The more important question is not the success rate *per se*, therefore, but its relationship to the overall error rates that seem to exist in NFIP claims processing. By this standard, however, the alleged 8-15 percent success rate does not sound so troubling. As described above FEMA's claims operation review data suggest that the overall payment error rate in the system is relatively low. More importantly, the *underpayment* rate found in the claims operation review and CRP data we have reviewed is lower still, and it is *this* rate to which one may more usefully compare policyholders' success rates on appeal, since it is generally only in cases of underpayment that FEMA examiners are likely to give policyholders what these claimants will view as a "success."[103] With claims operation review and CRP data suggesting that there is only a baseline underpayment rate in the first place, a relatively low success rate on appeal does not seem so problematic, from a policyholder's perspective.

More worrying than the reported success rate – and even than the approximately 25 percent vacancy rate in FIMA's Claims and Appeals Branch, which seems to be chronically understaffed[104] – are repeated complaints we have heard about more *qualitative* problems with FEMA's appeals process. Advocates for Sandy flood victims, for instance, have claimed that the

---

[102] FEMA data for Sandy claims tell a somewhat different tale, however. According to these figures, separately from the wholesale reevaluation of Sandy claims that began with FEMA's "Sandy Task Force," some 347 claims were "returned" to WYOs for reevaluation on the basis that FEMA had determined on appeal that "additional adjustment .. or review … is warranted." Out of a total of 2,517 Sandy claims, this suggests that the rate at which policyholders obtain reevaluation of their claims is just over 13 percent – though, as discussed elsewhere, this does not necessarily correlate to payments actually being made to them.

[103] This is not strictly true, however. In one remarkable case, a New Jersey NFIP policyholder sued the adjuster company Colonial Claims Corporation and several other defendants for their alleged role in "fraudulently" *overpaying* her $75,000 for flood damage from Superstorm Sandy. *See Brooks v. Foglio et al*., D.C.N.J., Civil Action 13-2504 (July 2, 2013), opinion of Judge Joseph Irenas.

[104] At the time of writing, FIMA's organizational chart shows only nine of the 12 positions in Claims and Appeals as being occupied.

appeals process is overly rigid and difficult. It is true, they say, that in theory a policyholder may at essentially any time file for a supplemental payment if it turns out that the costs of fixing covered damage are higher than originally estimated. They allege, however, that FEMA insists upon highly detailed cost-accounting for such supplemental claims – at a level of granularity more appropriate for a professional adjuster using Simsol or Xactimate software than an ordinary person forwarding to FEMA a cost estimate or receipts from a local contractor engaged to repair flood damage. These advocates strongly urge that FEMA be much more flexible about accepting different, and perhaps less exacting, forms of cost documentation.

Even apart from these complaints, moreover, our discussions with FEMA officials have revealed significant *structural* inadequacies in the claims appeals process. FEMA officials James Sadler and Jordan Fried proudly argued to Banking investigators that only full-time federal employees were used to review claims appeals, on the grounds that this important role was an "inherently governmental function" that should not be entrusted to mere contractors. What these officials initially neglected to mention, however – and which it took subsequent interviews to elicit – is that when these full-time employees find in favor of a policyholder in this appeals process, *they do not actually thereafter require that the policyholder be paid pursuant to this determination*.

If FEMA finds on appeal that more money is owed to the policyholder, it declines actually to determine the amount underpaid and simply *recommends* that the case be reevaluated by the responsible WYO (or the DSA) in light of its examiners' findings.[105] In fact, the standard FEMA letter to policyholders in such cases states simply that "some issues outlined in your appeal warrant further investigation" and that "the insurer will inform you, in writing, of the final disposition of this portion of your claim. … No further administrative review will be provided in this matter."[106]

To put it mildly, this approach is hard to reconcile with the idea of an "appeals procedure" at all. In such a case, FEMA has, in effect, determined that the policyholder was *right* in some important respect, and is duly owed more money under his NFIP policy, but the agency is neither willing actually to *say* so nor indeed to *order* that further payment be made accordingly. (The comment about how "no further administrative review will be provided," furthermore, makes it seem as if the policyholder is left at the mercy of the *insurer's* discretion without any further recourse apart from litigation – an approach which seems particularly absurd when one remembers that for Direct side claims appeals "the insurer" is actually FEMA, which runs those policies itself, through the DSA.) It is difficult to describe this as a defensible process for appealing claims determinations. At best, it has the form merely of a FEMA advisory opinion – and a deliberately opaque and evasive one at that.

Though FEMA officials admit that they do have legal authority to require that such payments be made, they *choose* not to do so. Nor does FEMA even track what happens after such mere recommendations are made in the appeals process: there exists no follow-up process

[105] Apparently, in a minority of cases, WYOs may be provided with an actual "recommendation" of additional payment, but even here the phrasing is apparently merely hortatory.

[106] FEMA, "Redacted Final Appeal Letter 052615," (notionally dated June 4, 2013), at 2 (as provided to Senate Banking Committee).

whereby FEMA checks whether or not the policyholder has in fact been paid what FEMA has found him to be owed. (At most, FEMA might look into the matter again if a policyholder contacts the agency later to complain that nothing further has happened – though policyholders could certainly be forgiven, on the basis of FEMA's form letter, for concluding that they have no right to expect further action apart from getting a letter from the insurer describing what it has decided to do.) Nor does FEMA track cases with any eye to using incoming appeals as a way to identify potential patterns of problems that arise in NFIP claims management.[107]

FEMA officials have argued that even though they do not *require* that policyholders be paid what the appeals process determined them to be owed – and that they do nothing to check what happens *after* an appeals decision is made – it is almost always the case that policyholders *are* properly paid after such determinations. We hope that this is true, and have seen no evidence that it is not.[108] That said, nothing requires that WYOs (or even FEMA itself, on the Direct side) actually *pay* policyholders even after these policyholders in effect *win* on appeal. We found FEMA's explanation for this merely hortatory appeals decision process to be incoherent,[109] and the agency's adoption of this mechanism difficult to understand.

FEMA officials, in fact, concede the indefensibility of this appeals decision process, saying that it clearly "needs to be reevaluated." As a sign of their interest in improving the handling of claims appeals, they have pointed to FEMA's recent decision to establish a new process for reopening Superstorm Sandy claims – a process in which FEMA examiners *will* order that each policyholder be paid whatever additional monies he is found to be owed. Pointing to the new Sandy process as an example of how the claims appeal process *should* work, however, simply highlights the inadequacy of the current *regular* process. It also makes clear that FEMA understands itself, in effect, to be discriminating against *non*-Sandy claimants by denying them the benefits of a claims appeal mechanism in which findings in the policyholders' favor are *mandatory* rather than merely hortatory. Since Sandy, NFIP policyholders in jurisdictions as diverse as Kentucky, West Virginia, and Texas have suffered greatly from flooding, and presumably in some cases have wished (or will wish) to appeal to FEMA over some aspects of the handling of their flood insurance claims. Effectively conceding the inadequacy of its current appeals process, however, FEMA continues to deny these non-Sandy claimants the more robust appeals mechanism that it now extends to Sandy policyholders in jurisdictions such as New York and New Jersey.

---

[107] FEMA's Brad Kieserman, in fact, faulted FEMA for having failed to pay attention to the warning signs of potential engineering problems that began to arise as appeals came in to FEMA as early as March 2013 alleging Sandy problems.

[108] According to FEMA, when an appeals decision is made in favor of the policyholder, that policyholder is sent a copy of the letter FEMA sends to the WYO (or the FEMA contractor on the Direct side of the flood program) recommending that the earlier partial or full denial of coverage be reevaluated.

[109] FEMA official James Sadler told Banking investigators that FEMA does not formally mandate payments in order to avoid impeding the "relationship" between the WYO carrier and the policyholder. The FEMA appeals process is exactly the same on the Direct side of the NFIP, however, where there are no WYO carriers, and thus no "relationship" to impede. (It is also worth noting that the issue here is *underpayment*, which is made good with FEMA money rather than out of the WYOs' own pockets.) Nor, in fact, does FEMA shrink from ordering payments to policyholders when underpayments are found in the context of CRP reinspections or claims operation review auditing. When asked why they feel comfortable ordering payments to policyholders in those contexts but not when the policyholder actually wins on appeal, FEMA officials could not provide any coherent answer.

The final pages of this Report offer recommendations with regard to how the NFIP can be made to run better and more fairly in light of what we have learned in the course of this review.

V. *Recommendations*

Key Points:

This Report does not address any specific allegations of fraud in any particular Sandy cases, but does conclude that important improvements are both possible and necessary in how the NFIP handles claims cases – especially in the wake of a major flood event:

- Training for adjusters and engineers needs to be systematized and improved, and FEMA should do more to ensure effective tracking and after-the-fact accountability for such experts in the event of incompetence or fraud.

- FEMA should improve its coordination of pre-crisis contingency planning and preparation for the deployment of adjuster, engineer, and other expert services.

- FEMA should improve its process for on-the-spot, error-correction and trend-spotting in the field after major events, and should explore the possibility of institutionalizing some sort of "second-look" error-correction process.

- FEMA should be more willing to provide written guidance to NFIP participants in order to prevent divergent interpretations of NFIP rules and approaches.

- FEMA should endorse and institutionalize a process of quality control review by expert adjusters and engineers in order to correct against errors in reports by field personnel, especially in the wake of major events that are likely to overwhelm available staffing resources.

- FEMA should institute a process whereby claims case appeals inside the agency result in *mandatory* payments when FEMA officials determine that the policyholder is correct. The current system of merely making recommendations to this effect is inappropriate.

- Both the WYOs and – especially – FEMA should greatly improve their internal recordkeeping and tracking capabilities for payment errors and overall error rates in claims management. This data is essential to proper oversight of the program, but has hitherto been poorly kept.

- The available information does not support a conclusion that WYOs are "the problem" with regard to claims management, either in Sandy or otherwise. FEMA should not act against any participant in the NFIP as a result of Sandy-related events without a strong evidentiary basis.

These recommendations will not prevent Sandy-type problems in the future, for these are probably not preventable. They should, however, reduce the incidence of such problems and – crucially – better equip the NFIP both to address problems in real time and to remedy mistakes made during the difficult crisis periods after a major flood.

On the basis of the information developed in the course of our review and the foregoing analysis, therefore, our recommendations are several:

(1) **Training and Certification.** The training and certification process for – and the professional accountability of – adjusters in the flood insurance program should be improved, and some such process should be created for engineers. As detailed above, at present, FEMA requires only that adjusters attend a one-day seminar on NFIP policy coverage, and that these adjusters have prior experience in some *other* (non-flood) aspect of property-casualty insurance, and carefully *avoids* providing any training or guidance on flood estimation "best practices" or the specific "how to" aspects of the job.[110] As for the engineers who sometimes feed such important information on structural damage and flood causation into the NFIP's claims adjusting process, FEMA itself neither provides any sort of guidance nor really requires any qualifications of them at all. FEMA should consider what steps can be taken to improve adjuster and engineer training.

In light of the difficulties we have seen with the "crash" augmentation of adjuster and engineer ranks under the pressure of the post-Sandy claims caseload, it would be somewhat perverse to respond to the challenges of reported adjuster and engineer inexperience in such crisis situations by *raising* the barriers to entry and thus depressing the "baseline" supply of such experts that is available to the NFIP in the first place. Better training and clearer flood-specific qualifications and guidance *are* needed, but care should be taken not to further cut the pool of available experts in ways that would make claims processing after the *next* flood event even more problematic.

One approach to consider, therefore, is to develop improved methods for providing near-real-time advice, on-the-spot training, "best practices" guidance to experts *already* in the field – most notably, to the expanded cadres of less experienced adjusters and experts who are likely to surge into the field to help handle the aftermath of a major event. As described in recommendation (3) below, part of this might involve an expanded role for FEMA GAs "on the scene" in crisis-affected areas. Beyond this, however, it is clear that FEMA could both do and require more to ensure that adjusters (and perhaps engineers) have more access to aid and assistance in the event that questions arise in the field. As described to Banking investigators, industry practice in the adjusting community presently varies considerably: some adjuster companies seem to provide much more extensive training, on-the-job evaluation and assistance, and expert field advice than others. FEMA should get over its fear of being "prescriptive" about professional standards, and work closely with WYOs, services vendors, and specialist companies to improve what is available to experts in the field with an eye to error-prevention.

[110] The application paperwork for a FCN *asks* whether the applicant has prior flood insurance experience or has ever had his license revoked, as well as whether the applicant has attended a company-sponsored training session. *See* FEMA, "Adjuster Certification Application," Form 086-0-21 (October 2010). These things, however, do not appear to be requirements.

More should also be done to develop means of after-the-fact accountability in the event of incompetence or misconduct by such personnel. Because they are both technically types of federal contractors, adjusters and engineers may, in theory, be subject to remedies of suspension and debarment from receiving federal contracting funds in the future in the event of serious misconduct. This remedy, however, appears to be more theoretical than real – being available only in the most egregious of cases, and reportedly not yet having ever been invoked by FEMA at all. At present, there seems to be essentially no way to hold either adjusters or engineers *professionally* accountable for problems, little or no way for the *state* authorities with which such experts may in fact hold licenses to evaluate or act against them for their role in administering the *federal* flood program,[111] nor in fact even any way for FEMA to track the claims on which any particular expert has worked across the NFIP.[112] This lack of tracking impedes both accountability and error correction, inasmuch as if a particular expert is discovered to be incompetent or to have engaged in misconduct in handling flood claims, it is very difficult either to discern the scope of the problem and identify his various NFIP cases for remedial attention,[113] or to put him on any sort of "blacklist" for the future.

FEMA officials have told Banking investigators that they hope to implement some kind of tracking system for such experts in the future, but this may be some time off.[114] FEMA should improve its ability to collect and monitor such information, and couple this with an accountability mechanism by which "problem" experts could – with appropriate due process protections – be identified and shut out of NFIP participation. The availability of such monitoring and after-the-fact consequences might do much to encourage careful attention to claims processing in the field.

---

111 According to an official with the BSA, for instance, if a complaint comes in against a particular adjuster through state channels, the state has little or no ability to do anything.

112 The NFIP is "required to maintain a database of independent adjusters who qualify to adjust flood claims under policies issued by the NFIP Direct and the Write Your Own (WYO) carriers who utilize the services of the independent adjusting community." This database, however, merely lists all certified adjusters by name and the date and location of the last annual NFIP claims presentation they attended. FEMA, "Adjuster Claims Manual" (September 2013 revision), at II-1, *available at* https://www.nfipservices.com/DesktopDefault.aspx?tabindex=5&tabid=35. Within the last year, FEMA's Direct-side vendor NFS has begun to collect adjuster FCNs as part of the data it collects for internal management purposes – though it did so on its own initiative rather than at FEMA's request or with FEMA's encouragement. In the future, at least for the Direct side of the program, this could permit FEMA to identify for remedial attention all claims files involving a particular adjuster who had been identified a problem.

113 This lack of FEMA-level data may be a particular problem because we have been told that individual adjusters may sometimes work for *multiple* companies, making WYO-level tracking less effective.

114 FEMA official James Sadler told Banking investigators that FEMA hopes to acquire such a tracking capability with their anticipated "Phoenix" computer system, but he did not express optimism about the timing of its arrival given FEMA's IT track record. There may be some reason for concern: FEMA's last effort to modernize its computer systems was a costly failure: the agency's "NextGen" IT program was canceled in 2009 after FEMA had spent $40 million on it over seven years. *See, e.g.*, GAO, *FEMA: Action Needed to Improve Administration of the National Flood Insurance Program* (GAO-11-297) (June 9, 2011).

(2) **Crisis Planning.** FEMA, the WYOs, and their vendors should improve mechanisms for flood event crisis planning. Banking investigators have been told that the means by which insurance carriers build and implement contingency planning scenarios for major storm events is much more highly developed in the non-flood property-casualty arena than in the NFIP domain – and that, in general, much more is done by private sectors entities to prepare for such crises (*e.g.*, with block hotel bookings and logistical arrangements for adjusters, the pre-deployment of hazard-removal teams, and other such steps) in the homeowners' insurance world than for flood insurance.[115] There may be much that can be learned from such experience and adapted to the NFIP context, and FEMA should do more to coordinate preparations, in advance, for the *next* major flood event.

(3) **Error-Prevention and Correction.** FEMA should also take steps to recreate some sort of error-*prevention* process for spotting and responding to characteristic *types* of problem that may develop in the wake of a particular flood event. Particular events sometimes present particularly salient problems. Hurricane Katrina, for instance, was characterized by difficulties in determining whether damage was due to wind or to floodwaters, while Superstorm Sandy involved relatively little wind damage but apparently presented great difficulties with regard to foundation damage (*i.e.*, whether such damage was caused by floodwaters or by varieties of earth movement not covered under NFIP policies) and the precise definition of a "basement" for purposes of NFIP coverage exclusions.[116] If FEMA had some way to identify such emerging *patterns* of problems fairly early in the aftermath of a flood event, it could issue interpretive guidance that would draw attention to these difficulties and provide all participants – WYOs, vendors, adjusters, engineers, and even policyholders themselves – with clarity about how they should be handled at a point before

---

[115] FEMA is proud of the steps it took before Sandy's landfall with regard to such things as pre-positioning commodities, generators, and communications vehicles, deploying liaison officers and assistance teams to regional operations centers, pre-deploying urban search-and-rescue personnel, pre-staging ground ambulances and medical teams, and dispatching Mobile Emergency Response System detachments to affected areas – but these more general emergency-preparedness measures do not relate to the actual *handling* of flood insurance claims. Nevertheless, with regard to claims management, FEMA pre-authorized "partial payments of up to $30,000 to cover building systems and related repairs when prompt action was necessary to preserve health and safety," "extended the timeframe in which an insured survivor could submit a proof of loss, from 60 days to one year from that loss," and "instituted a rapid claims process that resulted in some policyholders receiving up to $5,000 against their coverage for the building contents, pending final settlement of their claims." *See* FEMA, *Hurricane Sandy FEMA After-Action Report* (July 2013), at 4-5 & 19. Our Review does not gainsay any of these steps, but urges that FEMA explore how to make the NFIP, as a whole, better prepared for the more specific challenges of inexperienced "surge" manpower that it will inevitably have to confront (once again) in the wake of any extremely large flood event.

[116] NFIP rules exclude basements from flood insurance coverage, but the official FEMA definition of a "basement" provides merely that it is "[a]ny area of the building, including any sunken room or sunken portion of a room, having its floor below ground level (subgrade) on all sides." *See* FEMA, "Definitions" (September 5, 2014), *available at* https://www.fema.gov/national-flood-insurance-program/definitions#B. How precisely this should be applied to structures in the field is apparently sometimes difficult to ascertain.

many claims for that flood event have been closed out.[117] Such a prophylactic approach is surely far better than relying solely on after-the-fact error-correction.

As the CRP was originally formulated, its spot-inspections undertaken in the field by GAs just after a flood event might well have provided just this sort of opportunity to FEMA to identify, flag for attention, and give system-wide guidance on the handling of emerging, event-specific difficulties such as Katrina's "wind/water problem" or Sandy's "earth movement problem." As noted above, however, the CRP has since evolved into a much more *post hoc* error-correction mechanism, and its original "in the moment" utility has largely been lost. FEMA should take steps to reconstitute some such mechanism for facilitating systemic responses to such challenges while responses to them are still underway.[118] This might involve retaining a somewhat larger cadre of General Adjusters, so that more such expert eyes would be deployable to crisis locations as roving experts, both making ordinary adjusters more accountable by "looking over their shoulders" on a spot basis, and helping alert FEMA to emerging *types* of problem associated with that event. The basic conceptual groundwork for such a field-deployed error- and trend-spotting mechanism, however, has already been laid in the form of the *original* approach taken with the CRP.

FEMA should also consider how it might be able to provide a better error *correction* mechanism as a institutionalized part of claims management. In a crisis such as that created by Superstorm Sandy, there are powerful policy reasons to do at least *something* on as many claims as possible as quickly as possible, so that the great number of NFIP policyholders involved have to wait no longer than absolutely necessary to begin to receive service. It is possible, however, that such haste may result in increased error rates – that is, that commendable policy service *speed* may be purchased with some loss in claims estimation *accuracy*. This may well be a sensible policy trade-off for the NFIP to make, but *only* if the system is capable of expeditiously taking "second looks" at claims in order to correct errors that occur due to such haste. To some extent, this need can presumably be met if FEMA finally develops a sound claims appeal mechanism, but the agency should

---

[117] To its credit, FEMA is apparently beginning to explore such ideas. In a modest first step, FEMA officials told Banking investigators that they have established a new pilot program for the recent Texas flooding that would provide a telephonic FEMA "hotline" for communications from the field.

[118] Discussions with FEMA officials have suggested that the agency would require the development of a much-improved "real-time" IT system in order to do this. It is said, for example, that the original CRP approach was undermined by criticism that CRP GAs picked which properties to inspect based upon a statistically invalid sampling method based upon highly imprecise "quick-claim reports" created just after a flood event. Recreating some kind of emerging-problem inspection system, FEMA officials have argued, would require near-real-time processing of claims related information in a way that was statistically valid.

It may be, however, that this objection is overblown: even an imperfect selection mechanism based upon incomplete, imprecise, and very preliminary claims reporting might still allow CRP GAs to do valuable service in the field and to spot some emerging problems. The point is not to replicate the statistical significance and random-sample integrity of the *post hoc* CRP reinspections or the triennial claims operation reviews, but simply to get GAs "out there" in order to see what they can see as the NFIP's armies of contract adjusters and engineers struggle to handle the caseloads associated with a major flood event.

explore what additional possibilities for institutionalized "second look" evaluation may also exist.

(4) **Availability of Interpretive Guidance.** FEMA should also be less reticent about issuing written interpretive guidance. Since the explosion of public controversy over Sandy cases during the last few months, FEMA has produced a blizzard of successive bulletins demanding various things of NFIP participants, but the agency was apparently reticent about giving clear guidance before it felt an incentive to make its current public relations difficulties go away. Multiple WYOs, for instance, recounted having requested written interpretive guidance from FEMA on various issues, only to be met either by the issuance of vague *oral* comments or simply by silence. Other participants recounted WYOs and adjusters reacting to a lack of FEMA guidance on key matters by taking risk-averse, conservative interpretations of policy coverage issues.

An experienced adjuster told Banking investigators, for instance, that the statutorily-mandated NFIP policies say too little about what their various provisions actually *mean* with regard to some salient details that come up in actual cases (*e.g.*, how to handle water damage to such things as fasteners, sheeting, and siding), and this gap has to be filled by regulatory guidance from FEMA. He argued, however, that the guidelines provided by FEMA have sometimes been "woefully inadequate," and in practice, different adjusters and WYOs may operate on the basis of somewhat different assumptions. Legal advocates for Sandy claimants also told Banking investigators that their clients had experienced wide and potentially problematic variations in how individual adjusters approached key issues of flood coverage and damage estimation. (It is also telling, as we have seen, that while FEMA officials claim to have privately provided some guidance to WYOs actually involved in Sandy litigation, it has apparently never been willing publicly to correct what it claims are misinterpretations of NFIP rules that may lead some WYOs to avoid compromise settlements in claims lawsuits.) Some of these reported variations might have been avoided if the program's rules, procedures, and "best practices" had been clearer to all beforehand, particularly for field personnel rushed into service in order to handle the Sandy caseload.

Accordingly, we believe FEMA should be much more willing to provide guidance to NFIP participants, especially where they request when questions are raised or they experience challenges in their administration of the program.[119] Especially given the attenuated control linkages that characterize management of claims processing on both the WYO and the Direct side of the flood program, such system-wide FEMA guidance may often be the best (or only) way to prevent

[119] This is not a new idea. The Senate Banking Committee criticized FEMA in 2004 for "using unwritten rules or policies to make decisions, leaving policyholders, insurance agents[,] and others with no way of knowing what rules are to be used in the program." Senate Report 108-262, 108th Congress, 2nd Session (May 13, 2004), *available at* http://www.gpo.gov/fdsys/pkg/CRPT-108srpt262/html/CRPT-108srpt262.htm. It is disappointing, more than a decade later, to have been told by so many NFIP participants that some such problems continue.

systematic problems or diverging interpretations. FEMA's own bureaucratic risk-aversion should not stand in the way of ensuring that all participants in the flood program understand it as well as possible.

(5) **Quality Control Review.** Especially given the "Super-Event Problem" discussed above – that is, the inevitability that *really* large flood catastrophes will require more skilled and experienced adjuster and engineering manpower than will readily be available, that whatever personnel *are* pressed into service will be required to process large numbers of claims very rapidly in order to handle enormous case backlogs, and that problems and errors are sure to arise – the NFIP should endorse and institutionalize procedures of expert quality control review by supervisory cadres within flood-specialized contractor companies to police for errors made by inexperienced or overhasty field assessors.

FEMA should promulgate "best practices" guidance in order to help ensure that such quality control procedures are subject to appropriate transparency and *post hoc* accountability. Some such screening by specialized reviewers must be recognized, however, as being essential to claims adjusting and engineering quality control, especially in the wake of very large events when claims error rates are likely to be at their maximum. An institutionalized quality control review process might actually lead to fewer problems of "suspect" field reporting in the future, not only by ensuring that assessments that are drafted under potentially very challenging circumstances are seen by a "second set of eyes," but also by regularizing the *process* of review and making it more routinized, accountable, and transparent.

(6) **Claims Appeals.** FEMA should augment and improve its procedures for handling supplemental flood damage claims and claims appeals, particularly with regard to ensuring the reasonableness of data requirements with respect to cost documentation supplied by policyholders. If indeed, as alleged, FEMA currently requires highly-detailed documentation analogous to what an experienced adjuster might provide with the assistance of specialized software, it should reconsider this practice and adopt documentation rules more appropriate for how home repairs are actually done and documented in "the real world." It would be inappropriate to permit NFIP payments to be made on the basis of just *any* documentation, of course, but the agency should be willing to accept reasonably detailed paperwork from properly licensed and bonded contractors.

FEMA should also consider whether and how to allow more of a role for mediation or arbitration in claims cases. This should be done with care, however. While it may, in theory, be true that arbitration or mediation offers a fast and relatively inexpensive means for dispute resolution better suited for resolving small flood claims than are the formalities of courtroom litigation, it might yet be – as described earlier – that the NFIP's structure makes compromise settlements more difficult than might otherwise be the case.

Additionally or alternatively, FEMA may wish to consider what "lessons learned" it can draw from its ongoing process for re-examining Sandy claims files beyond simply those presently in litigation. It is possible that a version of this process – albeit a smaller one that is less improvisational and reactive[120] – might be able to provide an additional avenue for claims dispute resolution, at least in the wake of major events when one might expect claims processing error rates to be higher than in "baseline" years with less extreme flood conditions.[121]

At the very least, FEMA should move promptly to fix the structural flaw in its claims appeal process whereby decisions in policyholders' favor on appeal are merely *recommendations*. FEMA has no qualms about mandating that policyholders be paid what they are owed in other contexts – *i.e.,* when FEMA claims operation reviews or reinspections identify underpayments – and there is no defensible basis for the agency's present practice of not making claims appeal decisions obligatory. It is also inappropriate that FEMA would extend mandatory appeals procedures to Sandy victims but not to victims of other floods elsewhere in the country. There is no excuse for denying a robust appeals process to policyholders in states such as Kentucky and Texas just because FEMA faces political embarrassment over its handling of Sandy issues in states such as New York and New Jersey. When FEMA reviewers formally determine that a policyholder has not been paid all that he is owed, such a payment should be mandatory, not discretionary – and this should be true throughout the NFIP, not merely in selected jurisdictions.

(7) **Data Collection and Analysis.** FEMA should improve its ability to collect and track data from claims operation reviews and CRP reinspections, not merely keeping such information in searchable form but actively using it to track trends over time. FEMA officials have told Banking investigators that in the wake of all the questions being asked about patterns and trends in such data, they are now

---

120 As just one illustration, in an April 28, 2015, open meeting with several U.S. Senators concerned about reports of alleged fraud in some Sandy claims, for instance, FEMA's Brad Kieserman responded to complaints from a number of Senators' constituents present in the room by requesting their contact information and promising to "fast-track" their particular claims through the not-yet-announced Sandy claims review process outside of the agency's ordinary procedures under the guise of "beta-testing." Banking investigators do not believe it is an appropriate exercise of federal government power to favor specific claimants by allowing them to jump the queue over otherwise identically-situated peers simply because these claimants happened to be creating public embarrassment for a FEMA official at the time.

121 According to GAO, FEMA several years ago considered – and rejected – doing just that. To address the requirement of the Flood Insurance Reform Act of 2004 that it establish a regulatory appeals process, GAO reports, FEMA "discussed the feasibility of maintaining a permanent task force to consider appeals – like the one created to review Hurricane Isabel claims." GAO, "Federal Emergency Management Agency: Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program," GAO-06-119 (October 2005), at 33. FEMA may now wish to reconsider this rejection, especially given that the agency's track record – with the Isabel task force, the Katrina Fraud Task Force, and now the Sandy Task Force – suggests that it will end up establishing a special "task force" after each major flood event anyway. With some form of "task force" mechanism apparently all but inevitable one way or the other, it might be beneficial to regularize things and extricate FEMA somewhat from the problematic business of using *ad hoc* expedients as a means of episodic political damage control.

working to develop ways to do this – though they have not seemed too optimistic that this will occur quickly. Almost shockingly, FEMA officials do not appear consistently to have kept claims operation review data in any kind of organized and retrievable form prior to the last few years.[122]

When Banking investigators requested audit data for both the WYO and the Direct sides of the NFIP, FEMA said that it simply *could not find* older audit reports due to the poor state of its recordkeeping. (FEMA, its officials explained to Banking investigators, lacked any kind of formal recordkeeping policy prior to about 2011, and even today considers its recordkeeping rules to be "unclear" and in need of revision.[123]) There is no excuse for the agency simply *losing* the data with which it ensures quality control and should be able to track trends over time. FEMA's failure to keep, aggregate, and analyze this information, and to use it to assess trends over time – which is a failure not just by FEMA but by the contractor FEMA employs as its BSA in part precisely *in order* to track information and monitor trends over time[124] – is a systemic management and oversight failure, and has deprived NFIP policyholders of the benefits they might have reaped from a better-functioning program.[125]

---

122 Sometimes, in fact, FEMA seems to have fallen short even with regard to more recent data. FEMA said, for instance, that it had provided Banking investigators with all the review reports it possessed for one particular WYO, but it apparently failed to locate *the most recent* claims operation review FEMA had conducted on that company – a review that appears to have been finalized in May 2015, precisely at the point that Banking investigators were requesting FEMA to provide review reporting for the WYO in question. (Banking investigators acquired the 2015 report from the WYO itself.)

123 This recordkeeping policy is currently "under review." A new FEMA data-management system is also said to be likely to enter "full production" at some point in 2015.

124 The BSA's responsibilities – to be fulfilled by a company called OST, Inc. under a contract that FEMA renewed in June 2015 – include monitoring and overseeing the quality of WYO performance within the NFIP, and receiving and analyzing financial data and transaction-level statistical data that WYOs must report to FEMA. Under the previous contract, at least, the requirements included: serving as the "statistical analyst for all aspects of the program, including NFIP policy and claims experience," running a "program of internal audit, analysis and reporting," "[f]raming policy issues for resolution by the Mitigation Division," "coordinat[ing] claims quality control," and "provid[ing] feedback … on claims matters arising from re-inspections including common issues and trends." FEMA, Contract Number HSFEHQ-08-C-0130 (January 2, 2008), at J-3, J-4, J-6, & J-9.

Despite these theoretically broad analytical support roles, however, OST does not appear to have been providing – nor FEMA to have been requesting – anything more analytically deep than data-compilation. OST, for instance, is contractually obliged to "analyze and summarize the results of the re-inspections at the close of each fiscal year and provide a report" to FEMA on the subject. *Id.* at J-9. The "report" it provided to FEMA on the 2013 Sandy reinspections on the basis of such "analysis," however, consisted of nothing more than a Microsoft Excel spreadsheet in which this reinspection data had simply been assembled in tabular form. Unless OST has provided FEMA with analyses that have not been turned over in response to Banking investigators' requests for such information, this record of analytical support for the NFIP seems deficient.

125 This problem is also related to FEMA's movement, in CRP and claims operation review analysis, from nonrandom to random sampling under pressure from GAO studies criticizing the use of nonrandom approaches. The choice between random and nonrandom sampling methods is, in effect, a choice between auditing *philosophies*. Nonrandom sampling that tries to focus attention on the types of claim in which errors are *most likely* is in effect a choice to use the audit process to maximize the chances of finding and correcting errors. By contrast, because patterns in randomly-selected files can more plausibly be projected across the entire claims set, a choice to use *random* sampling improves the agency's ability to use auditing as a diagnostic tool for overall program management – even though this sort of usefulness comes at a cost (vis-à-vis nonrandom sampling) of a *lower* likelihood of finding and correcting individual errors. For this reason, at least for so long

These problems in FEMA recordkeeping and data-management also have implications for broader NFIP reform efforts. At the time of writing, FEMA officials such as Brad Kieserman have come publicly to advocate giving FEMA much more influence over the currently highly decentralized system of claims management. This review takes no position on whether this is, or is not, advisable. Unless and until FEMA fixes its serious information-management problems, however, such additional control might not help much, and could perhaps even be counterproductive. If greater centralized control is to be wise control, it cannot be *blind* control, and FEMA has some way to go before it is able to track and manage the data it needs in order to make such control effective.

Recordkeeping and tracking of NFIP claims data is clearly inadequate, and this is not only true with regard to FEMA. Banking investigators have been surprised and disappointed by the haphazard and often sloppy way in which some WYOs responded to requests for such data, too – and about how challenging it sometimes appeared to be for them even to *find* this information in their files. Getting the data needed for this review was much more difficult and time-consuming than it should have been, and neither FEMA *nor* the WYOs appear to have in place mechanisms for effective systematic monitoring and tracking of claims error data over time. Both FEMA and the WYOs should therefore work together greatly to improve their tracking and data-management procedures as quickly as possible.

(8) **The Role of the WYO Carriers.** From FEMA down to the adjuster community, our interview subjects consistently reported that the Direct and WYO sides of the program operate essentially identically, use many of the same vendors and contractors, and rely equivalently upon the judgment of independent contractors at the ends of attenuated systems of control. Whatever theoretical benefit there might be for FEMA in consolidating to a smaller number of WYOs, moreover – that is, in reducing the number of high-level actors whom FEMA officials have to oversee – the fact remains that FEMA does not seem to have been able to take advantage of such relative organizational simplicity where it already exists: on the entirely WYO-free Direct side."

The WYO and Direct sides saw the same sorts, and similar proportions, of problems in the wake of Superstorm Sandy, and neither their Sandy litigation "pickup" rates nor the critical error rates visible in their Sandy CRP and claims operation review data seem to differ very significantly. There is, in short, essentially no evidence that the WYOs are involved in any "systemic" problem visible as a result of Sandy that did not also occur in the portion of the NFIP in

---

as FEMA continues to *fail* to make good use of the statistically valid data it gets from auditing, GAO's success in pushing FEMA away from nonrandom and into random sampling may actually have harmed NFIP policyholders. Specifically, reducing the use of nonrandom sampling probably reduced the utility of audits and reinspections in correcting problems faced by individual policyholders, but FEMA's inability to manage and use the data resulting from *nonrandom* methodologies undercut what would otherwise have been these reviews' new importance as diagnostic and oversight tools through which to improve the effectiveness of the program.

> which there is no WYO involvement at all. (If anything, CRP data suggest that the Direct side of the program *underpays* policyholders more frequently than do the WYOs, and the WYOs *overpay* policyholders more frequently than does the DSA.) There is no sign at present that WYO numbers contributed to Sandy problems, nor even that WYO consolidation would enable FEMA to manage the NFIP better in the future.[126]
>
> There may well be productive public policy debates to be had about the degree to which WYO participation benefits the NFIP, just as major WYOs also report themselves periodically to reconsider whether the burdens and reputational risks of NFIP participation are really worth it from their perspective. Such ongoing evaluation and assessment is appropriate and constructive. On the basis of the information available at present, however, to react to the current spate of Sandy-related allegations by concluding that the WYOs were "the problem" – or even that WYO *numbers* were a problem – would be unwarranted. FEMA should not act against any NFIP participant without a solid evidentiary basis.

The philosophy that lies behind these recommendations is simple. Just as flood "super-events" cannot themselves be avoided, so also is it surely impossible to devise a bureaucratic and operational structure for the NFIP that will perform flawlessly under the trying circumstances of such a catastrophe. In facing such challenges, errors and various other problems will inevitably occur, without any need to suppose organized foul play as their cause, and no sweeping legislative or regulatory "fix" will be able to prevent this.

Rather than striving for some illusory state of perfection through heroic reimaginings of the NFIP structure, therefore – and doubtless thereby also creating all manner of new problems through the law of unintended consequences – our recommendations are structurally incrementalist. They are alive to the fact that large, complex structures will tend to perform badly when trying to cope with major events, and that a constructive reform agenda in the face of such complexity should focus not upon trying to achieve some comprehensive, perfect solution

---

[126] It should also be remembered that the WYOs' role also serves the NFIP's clear interest in maximizing participation in the flood insurance program. Different insurance companies have different geographic "footprints," and having many WYO carriers in the program permits flood insurance to be easily purchased essentially anywhere in the United States, as a convenient adjunct to lines of more conventional insurance purchased and serviced through broad, pre-existing networks of agents. Any effort to reduce WYO numbers would, at the least, need to devise a way to replicate this coverage so as to avoid suddenly making flood insurance more difficult to find in some areas of the country, and might in any event risk confusing or alienating would-be policyholders or current NFIP customers who have well-established relationships with WYO carriers and/or with the insurance agents who market policies and sell policies for the WYOs and provide important aspects of customer service under such policies. (Given the important role of WYOs' agents in *educating* policyholders about the terms of their policies, it would also be necessary – if WYOs were consolidated or perhaps even pushed out of the NFIP entirely – to replace this educative function without worsening the already very significant problems of policyholder confusion over coverage terms that our interview subjects encountered during the course of Sandy claims management.)

It is worth noting, moreover, that according to one experienced adjuster who spoke to Banking investigators, some of the WYOs manage their NFIP claims *better* than FEMA does on the Direct side (*e.g.*, in terms of having better overall business practices, superior communications and guidance, and managers who are more "in touch" with operational realities on the ground).

but rather upon managing imperfection: working to make the system more prepared for and resilient in the face of catastrophes, keeping error rates relatively low, and providing better error-correction and dispute resolution mechanisms for those claims that can be expected to fall through the cracks of even the best-designed program. Such a realistic approach to expecting and managing fallibility may not offer dramatic and satisfying fix-all solutions, but we believe it to represent good stewardship of the public interest in a complex, contingent, highly imperfect, and fundamentally non-controllable world.

In conclusion, it should be remembered that this Report cannot speak to allegations of fraud in any specific case or cases presently under litigation, and that we do not purport to offer the "last word" on any of the subjects touched herein. It does aim, however, to enrich debates in Congress and elsewhere in the U.S. policy community about the future of the NFIP, and to offer thoughtful suggestions on how to improve flood program management in light of the challenges created by Superstorm Sandy.

* * *

C.A. Ford
L. Moskowitz
B. Daner