

December 2006

# NATIONAL FLOOD INSURANCE PROGRAM

## New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved





Highlights of [GAO-07-169](#), a report to congressional committees.

## Why GAO Did This Study

In August and September 2005, Hurricanes Katrina and Rita caused unprecedented destruction to property along the Gulf Coast, resulting in billions of dollars of damage claims to the National Flood Insurance Program (NFIP). This report, which we initiated under the authority of the Comptroller General, examines (1) the impact of Hurricanes Katrina and Rita on the NFIP and paid losses by location and property type; (2) the challenges the Federal Emergency Management Agency (FEMA) and others faced in addressing the needs of NFIP claimants and communities; (3) FEMA's methods of monitoring and overseeing claims adjustments; and (4) FEMA's efforts to meet the requirements of the Flood Insurance Reform Act of 2004 to establish policyholder coverage notifications, an appeals process for claimants, and education and training requirements for agents. To conduct these assessments, GAO interviewed FEMA and insurance officials, analyzed claims data, and examined a sample of reports done on the accuracy of claims adjustments.

## What GAO Recommends

GAO recommends that FEMA analyze the overall results of reinspection reports on the accuracy of claims adjustments for future floods. The Department of Homeland Security reviewed a copy of this report and agreed with our recommendation.

[www.gao.gov/cgi-bin/getrpt?GAO-07-169](http://www.gao.gov/cgi-bin/getrpt?GAO-07-169).

To view the full product, including the scope and methodology, click on the link above. For more information, contact William O. Jenkins at (202) 512-8757..

# NATIONAL FLOOD INSURANCE PROGRAM

## New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved

### What GAO Found

NFIP paid an unprecedented dollar amount for a record number of claims from Hurricanes Katrina and Rita. Congress increased NFIP's borrowing authority with the U.S. Treasury from a pre-Katrina level of \$1.5 billion to about \$20.8 billion in March 2006, but FEMA will probably not be able to repay this debt on annual premium revenues of about \$2 billion. As of May 2006, NFIP had paid approximately 162,000 flood damage claims from Hurricane Katrina and another 9,000 claims from Hurricane Rita. Most paid claims were for primary residences where flood insurance was generally required.

FEMA and its private sector partners faced several challenges in processing a record number of flood claims from Hurricanes Katrina and Rita, among them were (1) reaching insured properties in a timely way because of blocked roadways and flood water contamination and (2) identifying badly damaged homes to be inspected in locations where street signs had washed away. Despite these and other obstacles, FEMA reported that over 95 percent of Gulf Coast claims had been closed by May 2006, a time frame comparable to those for closing claims in other, smaller recent floods. To help keep pace with the volume of claims filed, FEMA approved expedited methods for claims processing that were unique to Hurricanes Katrina and Rita.

To provide oversight of the claims adjustment process, FEMA's program contractor did quality assurance reinspections of Hurricane Katrina and Rita claims adjustments. FEMA did not adopt our October 2005 recommendation that it select the claims to be reinspected from a random sample of the universe of all closed claims; thus, the results of the reinspections cannot be projected to a universe larger than the 4,316 claims adjustments that were reinspected. FEMA agrees with our prior recommendation and plans to do quality reinspections in future flood events based on a random sample of all claims. FEMA did not analyze the overall results of the quality reinspections for Hurricanes Katrina and Rita.

FEMA has made progress but has not fully implemented the NFIP program changes mandated by the Flood Insurance Reform Act. For example, 15 states had adopted minimum education and training requirements for insurance agents who sell NFIP policies, as of October 2006.

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## **Abbreviations**

DHS	Department of Homeland Security
FEMA	Federal Emergency Management Agency
FIRM	Flood Insurance Rate Map
ICC	increased cost of compliance
NFIP	National Flood Insurance Program

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United States Government Accountability Office  
Washington, DC 20548

December 15, 2006

In late August 2005, Hurricane Katrina came ashore and destroyed or made uninhabitable an estimated 300,000 homes along the Gulf Coast of the United States. Hurricane Rita followed a few weeks later, making landfall in Texas and Louisiana and adding to the devastation, with Louisiana suffering the most damaging effects from both hurricanes. Much of the damage all along the Gulf Coast was the result of catastrophic flooding. As a result, the National Flood Insurance Program (NFIP) had a large role to play in the region's recovery. Federal Emergency Management Agency (FEMA) officials estimate that half of Hurricane Katrina and Rita flood victims were insured by the NFIP. Those who did have coverage filed more than five times the number of claims, through May 31, 2006, at 10 times the cost of any other prior flood event in NFIP history.

The NFIP was established in 1968 in part to provide some insurance protection for flood victims because private insurers were and are still largely unwilling to bear the economic risks associated with the potentially catastrophic impact of flooding. Under statute, homeowners may purchase up to \$250,000 of NFIP coverage on their dwellings and up to an additional \$100,000 for coverage of personal property (i.e., furniture and electronic equipment), and business owners may purchase up to \$500,000 of coverage on their building structures and \$500,000 on the contents.

As of June 2006, the NFIP had a little over 5.1 million policies in force. About 3 million of the policies, about 62 percent, were for properties in the five states affected by Hurricanes Katrina and Rita, and Florida had the largest number of policies of any state in the nation, with almost 2.1 million.<sup>1</sup> Homeowners are required to purchase flood insurance at least equal to the amount of their outstanding mortgage up to the maximum policy limit if (1) their property is within a designated special high-risk flood hazard area and (2) their mortgage was issued by a federally regulated lender. Optional, lower-cost coverage is available under the NFIP to protect homes in areas of low to moderate risk.

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<sup>1</sup>Alabama, Florida, Louisiana, Mississippi, and Texas are the five states in which major disaster declarations were made for Hurricane Katrina or Rita.

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The NFIP is intended to pay operating expenses and insurance claims with flood insurance policy premiums rather than tax dollars, but it has statutory authority to borrow funds from the U. S. Treasury to keep solvent in heavy loss years.<sup>2</sup> Historically, the NFIP has been able to repay funds borrowed from the Treasury to meet its claims obligations. However, the magnitude and severity of losses from Hurricane Katrina and other 2005 hurricanes required the NFIP to obtain borrowing authority of \$20.8 billion from the Treasury, an amount the program is unlikely to be able to repay while paying future claims with its current premium income of about \$2 billion annually. As a result of the catastrophic losses, we designated the program as a high-risk area in March 2006, and Congress is considering a number of legislative changes to improve the NFIP's financial solvency.<sup>3</sup>

The Federal Emergency Management Agency, within the Department of Homeland Security, administers the NFIP. FEMA pays 88 private insurance companies to perform the administrative functions of selling and servicing flood insurance policies and settling claims, although the companies do not assume risk for losses. To settle claims, including those from Hurricanes Katrina and Rita, insurance companies work with certified flood adjusters who assess damages and estimate losses. The NFIP pays for adjuster services according to a standard fee schedule. For example, for the average claims settlement amount for Hurricane Katrina, \$94,803, the NFIP fee schedule authorizes payment of 3 percent of the claim amount, or \$2,844, for adjusting services. FEMA is responsible for the management and oversight of the NFIP and is assisted in performing these functions by a program contractor. The NFIP also provides incentives for communities to adopt and enforce floodplain management regulations to reduce future flood damage.

After NFIP policyholders cited concerns regarding the processing and payments of claims after Hurricane Isabel in 2003, Congress passed the Flood Insurance Reform Act. This act reauthorized the program and directed FEMA to take actions to provide policyholders with additional information on their coverage, establish a regulatory appeals process for those who disagree with actions taken to settle their claims, and establish minimum education and training requirements for agents that sell policies. In addition, the Flood Insurance Reform Act authorized a pilot program to

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<sup>2</sup>42 U.S.C. § 4001(d) (2000); 42 U.S.C. § 4016 (2000).

<sup>3</sup>See GAO, *GAO's High-Risk Program*, [GAO-06-497T](#) (Washington, D.C.: Mar. 15, 2006).

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help reduce the inventory of properties that have had repetitive claims for flood damage.<sup>4</sup>

The unprecedented number of losses from Hurricanes Katrina and Rita confronted the NFIP with management and accountability challenges never before faced in its almost 40-year history. This report, prepared under the authority of the Comptroller General to initiate reviews on his own, (1) describes the impact of Hurricanes Katrina and Rita on the NFIP and the extent of the losses paid by location and type of property; (2) describes the challenges FEMA and its private sector partners faced and the results of their efforts to process flood claims from Hurricanes Katrina and Rita and address the needs of NFIP claimants and communities; (3) assesses FEMA's method of monitoring and overseeing claims adjustments and the results of that monitoring and oversight; and (4) assesses FEMA's efforts to implement the provisions of the Flood Insurance Reform Act of 2004 by establishing notifications on coverage to policyholders, an appeals process for claimants, agent education and training requirements, and a pilot program to help reduce the number of insured properties that have sustained repeated severe flood losses.

We have recently completed or have under way several other reports and testimonies related to FEMA's administration and management of the NFIP. In October 2005, we issued a report that reviewed, among other things, FEMA's monitoring and oversight of the NFIP and the status of its implementation of provisions of the Flood Insurance Reform Act of 2004. In that report, we recommended that FEMA use a statistically valid method to select claims for review and establish milestones for meeting provisions of the Flood Insurance Reform Act. We testified on the results of that work before the Senate Committee on Banking, Housing and Urban Affairs and the House Financial Services Committee Subcommittee on

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<sup>4</sup>Hurricane Isabel caused flood damage in Delaware, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, and Washington, D.C., that resulted in 19,523 claims for which the NFIP paid \$456 million to policyholders. The NFIP reauthorization legislation is the Bunning, Bereuter-Blumenauer Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, 118 Stat 712 (codified in scattered sections of 42 U.S.C. (2004)).

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Housing and Community Opportunity.<sup>5</sup> In January 2006, we testified again before the Senate Committee on Banking, Housing and Urban Affairs on challenges facing the NFIP.<sup>6</sup> In addition, we have work under way to examine the cost of operating the NFIP, including fees paid for the services of private insurance companies and claims adjusters. We anticipate issuing a report on that work in 2007. In other related work on catastrophe insurance issues, we are reviewing natural hazard loss mitigation activities and assessments of hurricane damages caused by wind versus flooding. We also anticipate reporting on this work in 2007.

To describe the impact of Hurricanes Katrina and Rita on the NFIP and the extent of the losses paid by location and property type, we reviewed congressional actions to increase the NFIP borrowing authority, and we interviewed the Director and other officials of FEMA's Mitigation Division. We also analyzed data on claims payments from the NFIP management information system. We tested the reliability of the NFIP database to assure ourselves that the information we obtained from it was sufficiently reliable for our reporting purposes.

To describe the challenges FEMA and its private sector partners faced and the results of their efforts to process flood claims resulting from Hurricanes Katrina and Rita and address the needs of NFIP claimants and communities, we interviewed selected headquarters and field officials of FEMA and its program contractor. We conducted semistructured interviews with insurance industry officials involved in the recovery effort selected on the basis of our judgment. Their views are not representative of the universe of all insurance industry officials involved in the flood recovery effort. We documented policies and procedures in place for claimants who disagreed with actions taken to settle their claims, and we collected and analyzed available NFIP data on complaints and appeals filed by claimants. We also interviewed selected officials regarding actions taken to develop and issue advisory opinions on elevations for rebuilding

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<sup>5</sup>See GAO, *Federal Emergency Management Agency: Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program*, (GAO-06-119 (Washington, D.C.: Oct. 18, 2005); GAO, *Federal Emergency Management Agency: Challenges Facing the National Flood Insurance Program* (GAO-06-174T (Washington, D.C.: Oct. 18, 2005); and GAO, *Federal Emergency Management Agency: Oversight and Management of the National Flood Insurance Program*, (GAO-06-183T Washington, D.C.: Oct. 20, 2005).

<sup>6</sup>See GAO, *Federal Emergency Management Agency: Challenges for the National Flood Insurance Program*, GAO-06-335T (Washington, D.C.: Jan 25, 2006).

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after the hurricanes in 15 Louisiana and Mississippi communities, and we reviewed the advisories and analyzed impacts on the communities' recovery efforts.

To assess FEMA's role in monitoring and overseeing the NFIP and the results of that oversight, we examined guidance for the quality assurance reinspections that FEMA's program contractor conducts for a sample of claims adjustments after every flood event and followed up on action taken on our prior recommendation for improvements in the quality reinspection program.<sup>7</sup> We interviewed FEMA and program contractor officials involved in the quality assurance process, and we conducted a review of a random sample of the quality reinspections done of Hurricane Katrina and Rita claims adjustments.<sup>8</sup>

To assess the status of FEMA's efforts to implement provisions of the Flood Insurance Reform Act of 2004 after Hurricanes Katrina and Rita, we interviewed FEMA officials and examined documentation of the actions FEMA took. We assessed FEMA's actions to comply with the provisions to determine whether they met the legal requirements of the act. We performed our work from December 2005 through November 2006 in accordance with generally accepted government auditing standards. Our scope and methodology are discussed in greater detail in appendix 1.

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## Results in Brief

Hurricane Katrina, closely followed by Hurricane Rita, had a far-reaching impact on the NFIP. Both the number of claims paid and the value of claims payments were unprecedented. As a result, claims for damages from the 2005 hurricane season far exceeded the ability of the NFIP to pay for them. The NFIP's borrowing authority with the U.S. Treasury was increased from \$1.5 billion before Hurricane Katrina to about \$20.8 billion in March 2006. As we have reported, it is unlikely that the NFIP will be able to repay this debt and pay future claims with annual insurance premium revenue of about \$2 billion.<sup>9</sup> Legislation has been introduced in Congress to forgive the debt, and attention has focused on the extent of the federal government's exposure for future catastrophic losses and ways

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<sup>7</sup>See [GAO-06-119](#).

<sup>8</sup>Percentage estimates from our sample have 95 percent confidence intervals of within +/- 5 percentage points of the estimate.

<sup>9</sup>See [GAO-06-335T](#).

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to improve the program's financial solvency. As of May 2006, with over 95 percent of the claims reported by FEMA to be closed, the NFIP had paid claims for about 162,000 losses for flood damage from Hurricane Katrina in Alabama, Florida, Louisiana, and Mississippi. About 135,000 of these claims (about 83 percent) were in Louisiana. As of July 2006, more than 83,500 claims resulted from property damage in the New Orleans area. About 9,000 additional NFIP claims, over 7,000 of them in Louisiana, were paid as a result of losses from Hurricane Rita. To put the number of loss claims in perspective, the NFIP processed a little more than 30,000 claims in each of the two largest single flood events prior to Hurricane Katrina, a 1995 Louisiana flood and Tropical Storm Allison in 2001. The average amount paid per claim for Hurricane Katrina flood damages, about \$94,800, was about three times the average paid per claim in the previous record year, 2004, for damages from flood events including Hurricanes Charley, Ivan, Frances, and Jeanne in Florida and other East Coast and Gulf Coast states. Most paid losses were for primary residences within special flood hazard areas in which flood insurance was generally required, but about 16 percent of claims for noncondominium residential losses from Hurricane Katrina (24,511) were for nonprincipal residences (i.e., second homes), and (about 22 percent) of claims paid for Hurricane Katrina (about 36,000) were on properties outside of the special flood hazard areas where purchase of flood insurance is optional.

The magnitude and severity of the damages from Hurricane Katrina closely followed by Hurricane Rita presented FEMA and its private sector NFIP partners with challenges to accurately process a record number of flood claims in a timely manner and address other needs of NFIP claimants and communities. Among the challenges FEMA and private sector officials we interviewed said they faced were difficulties in (1) reaching the insured properties for up to a month because debris blocked roadways and flood waters contaminated houses, and (2) identifying the demolished homes to be inspected on streets where signs had washed away. Despite these and other obstacles, FEMA reported that over 95 percent of the Gulf Coast claims were closed by May 2006, about 9 months after the storms struck. The time periods for closing claims were comparable to those for closing claims in other, smaller recent flood events. Concerns from claimants about actions taken to settle their claims were relatively few in relation to the large number of claims filed. For example, as of April 2006, 13 appeals had been filed by claimants related to settlements of their claims for Hurricane Katrina damage, and no appeals had been filed on claims for damage from Hurricane Rita. To help keep pace with the volume of claims filed and assist policyholders, FEMA approved expedited methods for claims processing that were unique to Hurricanes Katrina and Rita and

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took other special actions to assist claimants. In some circumstances where data showed that flood losses exceeded policy limits, FEMA authorized claims payments to policy limits without site visits by certified flood claims adjusters or allowed the use of models that paid claims based on the square footage of the home and general classification by adjusters of the quality of its building materials (i.e., flooring and doors). FEMA authorized payments to its private insurance company partners of \$750 per expedited claim adjustment—a lower fee than would have been paid for a more time-consuming room-by-room, line-item-by-line-item visual assessment of flood damage.

As in previous flood events, FEMA's primary method of monitoring and overseeing claims settlements and addressing concerns from claimants was its quality reinspection program. Employees of FEMA's program contractor are to reinspect a sample of claims adjustments for every flood event to identify errors, among other things. As of August 2006, FEMA's program contractor had conducted quality assurance reinspections of 4,316 Hurricane Katrina and Rita claims. FEMA also organized a special task force to review an additional 1,696 claims adjusted using expedited methods. However, FEMA neither used a random sample of all claims closed for its reinspections nor analyzed the overall results of those reinspections to determine the total number of payment errors and their potential causes—actions that we have reported are necessary to meet our internal control standard that FEMA have reasonable assurance that program objectives are being achieved (e.g., claims are settled accurately) and its operations are effective and efficient. Instead of using a random sample of all closed claims, as we recommended in October 2005, FEMA's sample selection was based upon judgmental criteria including, among other items, the size and location of loss and complexity of claims. Consequently, the results of FEMA's NFIP quality reinspection program for Hurricanes Katrina and Rita cannot be projected to a population larger than the 4,316 claims adjustments that were reinspected. As a result, FEMA is unable to determine the overall accuracy of claims settled for specific flood events. A FEMA official told us that FEMA expects to use a random sample for future flood events, as we recommended, but was not able to do so in the aftermath of Hurricanes Katrina and Rita because other priorities to meet the needs of claimants and communities took precedence. Neither FEMA nor its program contractor analyzed the overall results of the 4,316 quality reinspections for Hurricanes Katrina and Rita done between January and September 2006 to identify the total number of payment errors and the magnitude of those errors. We reviewed a random sample of these 4,316 reinspections and estimated there were payment errors in about 14 percent of the Hurricane Katrina reinspected

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claims adjusted using regular processes, 1 percent of the Hurricanes Katrina and Rita reinspected claims adjusted using expedited methods, and 2 percent of Hurricane Rita reinspected claims adjusted using regular processes. Payment errors identified in our review of reinspection reports for Hurricane Katrina claims settled using regular processes included 8 underpayments that ranged from more than \$131,000 to \$543 and 36 overpayments that ranged from \$65,000 to \$86.<sup>10</sup> Because, in the past, FEMA has had neither an appropriate sampling methodology nor a requirement for an overall analysis of the accuracy of the claims adjustments after every flood event, we do not know how the error rates we identified compare to adjusting errors in other smaller flood events. FEMA has procedures in place to recover overpayments made by insurance companies and adjust payments to policyholders for underpayments.

FEMA made progress in implementing the NFIP program changes provided for in the Flood Insurance Reform Act of 2004, since we last reported on the status of the implementation in October 2005.<sup>11</sup> However, implementation is not yet complete. The act mandated FEMA by December 30, 2004, to (1) develop supplemental materials for explaining NFIP coverage and the claims process to policyholders when they purchase and renew policies; (2) establish, by regulation, an appeals process for claimants; and (3) establish, in cooperation with the insurance industry, state insurance regulators, and other interested parties, minimum training and education requirements for flood insurance agents and publish the requirements in the *Federal Register*. The act also authorized FEMA to create a pilot program to provide financial assistance to states and communities to carry out certain activities, including elevating and demolishing structures that have suffered severe and repeated damage from flooding.<sup>12</sup> FEMA has met the requirements of the act to establish notifications on coverage to policyholders and an appeals process for claimants. With respect to the requirement that it establish minimum education and training requirements for agents who sell NFIP policies, FEMA published a notice in the *Federal Register* in September 2005, stating that it intended to implement the standards through existing state

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<sup>10</sup> In two instances, we could not identify underpayment amounts and in one instance we could not identify an overpayment amount.

<sup>11</sup> See [GAO-06-119](#).

<sup>12</sup> *Id.* At § 102 (codified at 42 U.S.C. § 4102a (2004)).

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licensing schemes for insurance agents. To that end, FEMA has actively solicited partnerships with state legislators and the insurance industry to implement training standards. However, as we reported in October 2005, FEMA has not developed milestones for state adoption of minimum training and education requirements.<sup>13</sup> As of October 2006, 15 states have established minimum training and education requirements for insurance agents that sell NFIP policies. Two states have issued advisory notices, and 1 state has established standards for a continuing education course in flood insurance but has not made the course mandatory.<sup>14</sup> As of October 2006, FEMA had not developed and issued guidance for implementing the pilot program authorized by the act to help reduce the inventory of NFIP properties that have sustained repeated severe flood losses. However, officials said that they had made progress in developing the program guidance and implementing regulations.

To strengthen and improve FEMA's monitoring and oversight of the NFIP, including ensuring that claims payments are accurately determined, we are recommending that FEMA analyze the overall results of a statistically valid sample of claims adjustments to be completed for each future flood event to determine the number and types of claims adjustment errors made and to help determine whether new, cost-efficient methods for adjusting claims that were introduced after Hurricane Katrina are feasible to use after other flood events.

In commenting on a draft of this report, the Department of Homeland Security (DHS) agreed with our recommendation to improve its quality reinspection program and stated that it was revising its guidance accordingly and would use the recommended sampling and reporting procedures in future flood events. DHS reiterated a comment made in FEMA's review of our October 2005 report that we did not review all of the controls and processes that FEMA has in place to provide oversight for the NFIP. Most of the additional oversight and management processes and controls that FEMA has in place are for financial management—an area not included in the scope of our work for this report but to be addressed in work that we have under way. DHS also provided additional information about the determination of the number of quality control reinspections to

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<sup>13</sup>See [GAO 06-119](#).

<sup>14</sup>Eleven of the 14 states that implemented minimum training standards did so through bulletins or advisory opinions, which are not enforceable by law but are enforced in practice.

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be performed after flood events and actions it has taken to implement the provision of the Flood Insurance Reform Act of 2004 to establish, in cooperation with the insurance industry, state insurance regulators, and other interested parties, minimum training and education requirements for flood insurance agents and publish the requirements in the *Federal Register*. DHS's comments are contained in appendix VI. In addition, DHS provided a technical comment, which we incorporated into the report.

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## Background

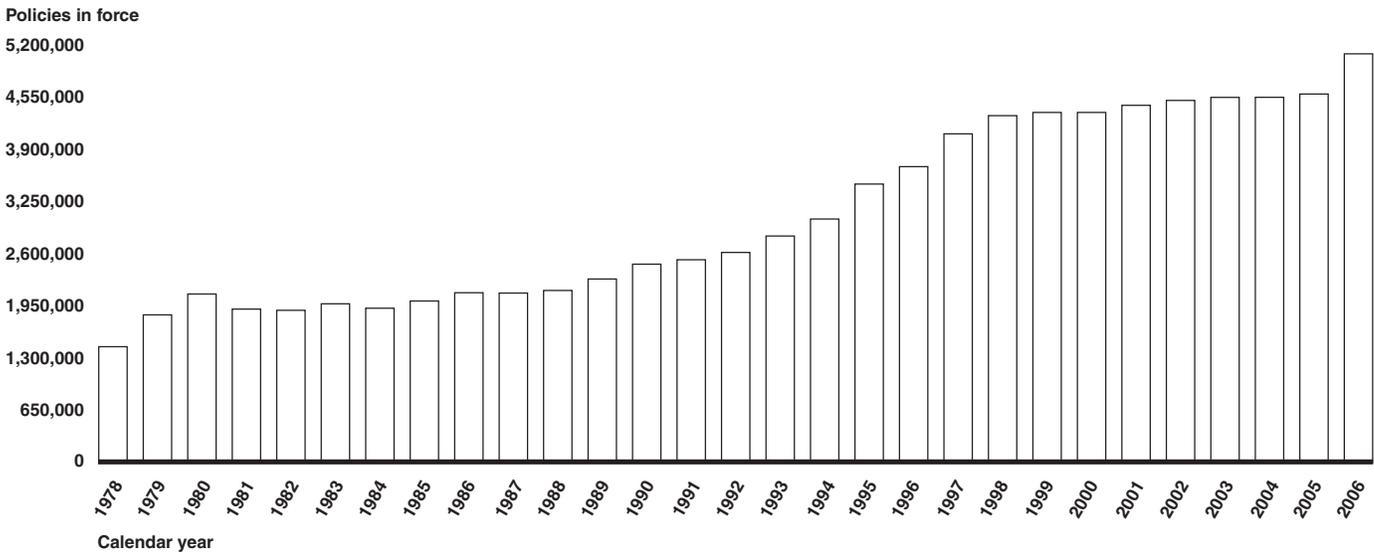
Ninety percent of all natural disasters in the United States involve flooding. Although homeowner insurance policies typically cover damage and losses from fire or theft and often from wind-driven rain, they do not cover flood damage because private insurance companies are largely unwilling to bear the economic risks associated with the potentially catastrophic impact of flooding. To provide some insurance protection for flood victims, as well as incentives for communities to adopt and enforce floodplain management regulations to reduce future flood damage, and to reduce the amount of federal disaster assistance payments, federal law established the NFIP in 1968.<sup>15</sup> The legislative history of the National Flood Insurance Act recognized that insurance for existing buildings constructed before the NFIP was established would be extremely expensive because most of them were flood prone and did not comply with NFIP floodplain management standards that went into effect after they were built. The authorizing legislation included provisions for subsidized insurance rates to be made available for policies covering certain structures to encourage communities to join the program. Under the NFIP, the properties are generally referred to as Pre-FIRM (Flood Insurance Rate Map) buildings.

As shown in figure 1, the NFIP has grown from about 1.5 million policies in 1978 to 5.1 million policies in July 2006.

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<sup>15</sup>The National Flood Insurance Act of 1968, as amended, is codified at 42 U.S.C. 4001-4129.

**Figure 1: NFIP Policies in Force, 1978–2006**



Source: FEMA.

## NFIP Provides Insurance and Maps Flood Risk for Communities That Agree to Enforce Land Use Regulations

More than 20,100 communities nationwide participate in the NFIP. To participate in the program, communities agree to enforce regulations for land use and new construction in high-risk flood zones. In exchange, the NFIP studies and maps flood risks and makes federally backed flood insurance available to homeowners and other property owners. The maps identify special high-risk flood hazard areas, also known as the 100-year floodplain. These areas have a 1 percent chance of being flooded in any given year or at least a 26 percent chance of being flooded over the 30-year life of a typical home mortgage.

Property owners in the special high-risk flood hazard areas whose communities participate in the NFIP and who have mortgages from federally regulated lenders are required to purchase flood insurance on their dwellings for at least the outstanding amount of their mortgages up to the maximum policy limit of \$250,000. Optional lower-cost coverage is also available under the NFIP to protect homes in areas of low to moderate risk. To insure furniture and other personal property items against flood damage, homeowners may purchase separate NFIP personal property coverage. Maximum coverage amounts under the NFIP are \$250,000 for dwellings and \$100,000 for personal property.

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Accurate flood maps that identify the areas at greatest risk of flooding are the foundation of the NFIP. Flood maps must be periodically updated to assess and map changes in the boundaries of floodplains that result from community growth, development, erosion, and other factors that affect the boundaries of areas at risk of flooding. FEMA is in the midst of a multi-year effort to update the nation's flood maps at a cost in excess of \$1 billion. The maps are principally used by (1) more than 20,100 communities participating in the NFIP to adopt and enforce the program's minimum building standards for new construction within the maps' identified flood plains, (2) FEMA to develop flood insurance policy rates based on flood risk, and (3) federally regulated mortgage lenders to identify those property owners who are required to purchase federal flood insurance.

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## Private Insurers Sell Policies and Adjust NFIP Claims under FEMA Oversight and Management

The work of selling, servicing, and adjusting NFIP claims is carried out by thousands of private sector insurance agents and adjusters who work independently or are employed by insurance companies, adjusting firms, or designated subcontractors under the oversight and management of FEMA within the Department of Homeland Security. According to FEMA, about 95 percent of the NFIP policies in force are written by insurance agents who represent 88 private insurance companies that are paid fees for performing administrative services for the NFIP but do not have exposure for claims losses.<sup>16</sup> The companies, called write-your-own companies, receive an expense allowance from FEMA of about one-third of the premium amounts for their services and are required to remit premium income in excess of this allowance to the National Flood Insurance Fund.<sup>17</sup> The write-your-own companies also receive a percentage fee—about 3.3 percent of the incurred loss—for adjusting and settling claims.<sup>18</sup>

To settle claims, including those from Hurricanes Katrina and Rita, insurance companies work with certified flood adjusters. When flood

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<sup>16</sup>The other 5 percent of policies are sold and serviced by state-licensed insurance agents and brokers who deal directly with FEMA.

<sup>17</sup>The fund, which was established in the Treasury by the 1968 legislation authorizing the NFIP, is the account into which premiums are deposited and from which losses and operating and administrative costs are paid. See 42 U.S.C. 4017.

<sup>18</sup>The fee is paid by the NFIP for costs to establishing and staffing operations centers in flooded communities, according to a FEMA official.

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losses are reported, the write-your-own companies assign a flood adjuster to assess damages. Flood adjusters may be independent or employed by an insurance or adjusting company. These adjusters are responsible for assessing damage, estimating losses, and submitting required reports, work sheets, and photographs to the insurance company, where the claim is reviewed and, if approved, processed for payment. Adjusters determine the price for repairs by reviewing estimates of costs prepared by policyholders and their contractors, consulting pricing software, and checking local prices for materials.

Adjusters are paid for their services according to a standard fee schedule that is paid in addition to the fees paid to the insurance companies. Adjusters who work for an adjusting company share the fees with the company in exchange for adjusting assignments and administrative support. For example, for the average claims settlement amount for Hurricane Katrina, \$94,803, the NFIP fee schedule authorizes payment of 3 percent of the claim amount, or \$2,844, for adjusting services. For claims adjusted under the expedited claims processing procedures that were introduced after Hurricane Katrina, FEMA authorized payment of \$750 for each claim plus an additional \$400 if a site visit was required later in the claims adjustment process.

Among the requirements for certification as a claims adjuster for the NFIP are at least 4 consecutive years of full-time property loss adjusting experience, attendance each year at an NFIP adjuster workshop, and demonstration of knowledge of the standard flood insurance policy by passing a written examination. In 2002, FEMA modified the minimum experience requirement to allow adjusters who do not have the requisite experience to work with a seasoned flood adjuster until the write-your-own company determines that the adjuster is able to work independently.

Claimants who have questions or concerns about actions taken to resolve their claims have several avenues of recourse. Claims amounts may be adjusted after the initial settlement is paid if claimants submit documentation that some costs to repair or replace damaged items were higher than estimated. If a claimant is not satisfied with the adjuster's answers or does not agree with decisions, the claimant or the write-your-own company can request FEMA's program contractor for assistance in reaching a resolution by conducting a special assistance reinspection of the claim. Also, under provisions of the Flood Insurance Reform Act of 2004, claimants may contact FEMA directly to resolve concerns that were not addressed through the other channels. Finally, claimants may bring a claim in federal district court against the insurer.

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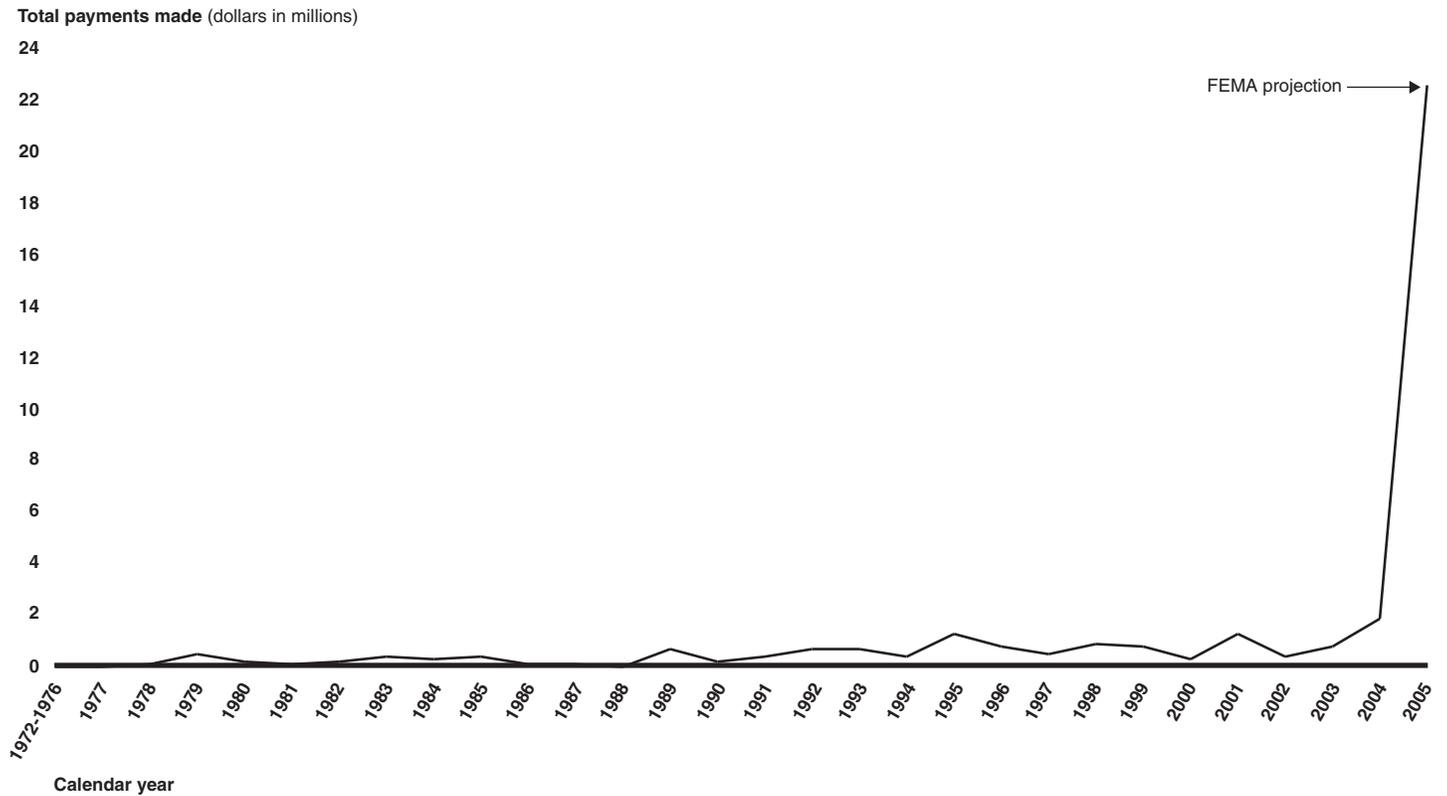
About 40 FEMA employees, assisted by about 170 contractor employees, are responsible for managing the NFIP. Management responsibilities include establishing and updating NFIP regulations, administering the National Flood Insurance Fund, analyzing data to actuarially determine flood insurance rates and premiums, and providing training to insurance agents and adjusters. In addition, FEMA and its program contractor are responsible for monitoring and overseeing the quality of the performance of the write-your-own companies to ensure that the NFIP is administered properly (i.e., appropriate claims settlements are made and program objectives are achieved).

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## Hurricanes Katrina and Rita Had a Far-Reaching Impact on the Financial Solvency of the NFIP

Hurricane Katrina, followed closely by Hurricane Rita, had a far-reaching impact on the financial solvency of the NFIP. By all measures, the flood losses were unprecedented in the history of the NFIP. FEMA projects that when all claims are settled, claims from NFIP policyholders who suffered flood damage from Hurricanes Katrina and Rita will total more than \$20 billion. In contrast, the NFIP reports that from its inception in 1968 until August 2005, it paid a cumulative total of about \$14.6 billion in claims. In the two largest single flood events prior to Hurricane Katrina, the NFIP reports that it processed a little more than 30,000 claims after a Louisiana flood in 1995 and Tropical Storm Allison in 2001. Figure 2 illustrates the magnitude of the flood losses in 2005 compared to losses over the history of the NFIP.

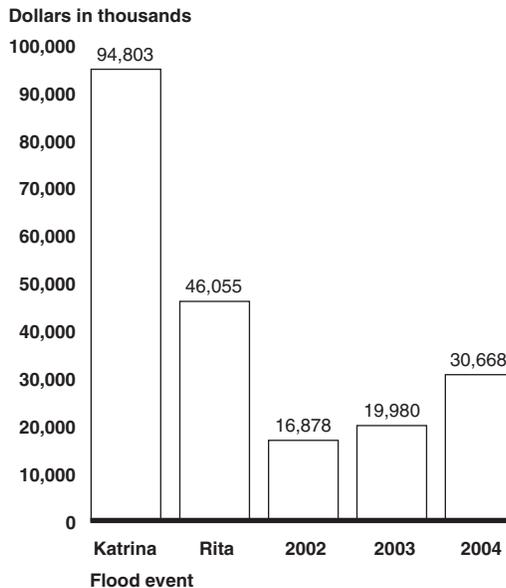
**Figure 2: Total NFIP Payments to Claimants, 1972–2005**



Source: FEMA.

Not only were the total cost and number of Hurricane Katrina and Rita claims far greater than in prior flood events, the amount paid per loss was also greater. As shown in figure 3, the average amounts paid per claim for Hurricanes Katrina and Rita flood damages—about \$94,800 and \$46,000, respectively—were much larger than average claims amounts reported as paid in the 3 prior years. Average paid losses for Hurricane Katrina were about three times the average paid losses reported by the NFIP for damage from flood events in 2004, including Hurricanes Charley, Ivan, Frances, and Jeanne in Florida and other East Coast and Gulf Coast states.

**Figure 3: Average Loss Payments for Hurricanes Katrina and Rita and Flood Events from 2002 to 2004**



Source: GAO analysis of NFIP data.

As a result of the number and amount of claims for damages from the 2005 hurricane season and particularly Hurricane Katrina, losses to be paid far exceeded the NFIP's existing borrowing authority with the U.S. Treasury. The borrowing authority was subsequently increased from \$1.5 billion before Hurricane Katrina to \$18.5 billion in November 2005, and then to \$20.8 billion in March 2006 to pay claims and expenses from Hurricane Katrina and other 2005 hurricanes. As of September 30, 2006, FEMA's debt to the Treasury was \$16.9 billion. As we reported in January 2006, it is unlikely that FEMA will be able to repay a debt of this size and pay future claims in a program that generated premium income of about \$2 billion in fiscal year 2005.<sup>19</sup>

To the extent possible, the NFIP is designed to pay operating expenses and flood insurance claims with premiums collected on flood insurance policies rather than by tax dollars. However, by design, the program is not actuarially sound because federal law authorized subsidized insurance rates to be made available for policies covering some properties to

<sup>19</sup>See [GAO-06-335T](#).

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encourage communities to join the program. As a result, the program does not collect sufficient premium income to build reserves to meet the long-term future expected flood losses.

In November 2006, legislation was pending in both houses of Congress to reform the NFIP. A Senate provision would forgive the NFIP debt and bills in both houses had provisions to improve the financial solvency of the program and reduce the extent of the federal government's exposure for losses in catastrophic loss years. For example, proposed legislation in both the Senate and the House of Representatives contain provisions that would allow premium increases of up to 15 percent annually on NFIP policies, up from the current cap of 10 percent on premium increases. Additionally, legislation in both houses of Congress would phase out subsidized rates for some properties built before flood insurance rate maps were put into effect in their communities, including nonresidential properties and those that are not primary residences. However, none of the proposals, if enacted, would make changes to the NFIP that would result in collecting enough premium income to cover losses for any future flood events of the magnitude of Hurricane Katrina.

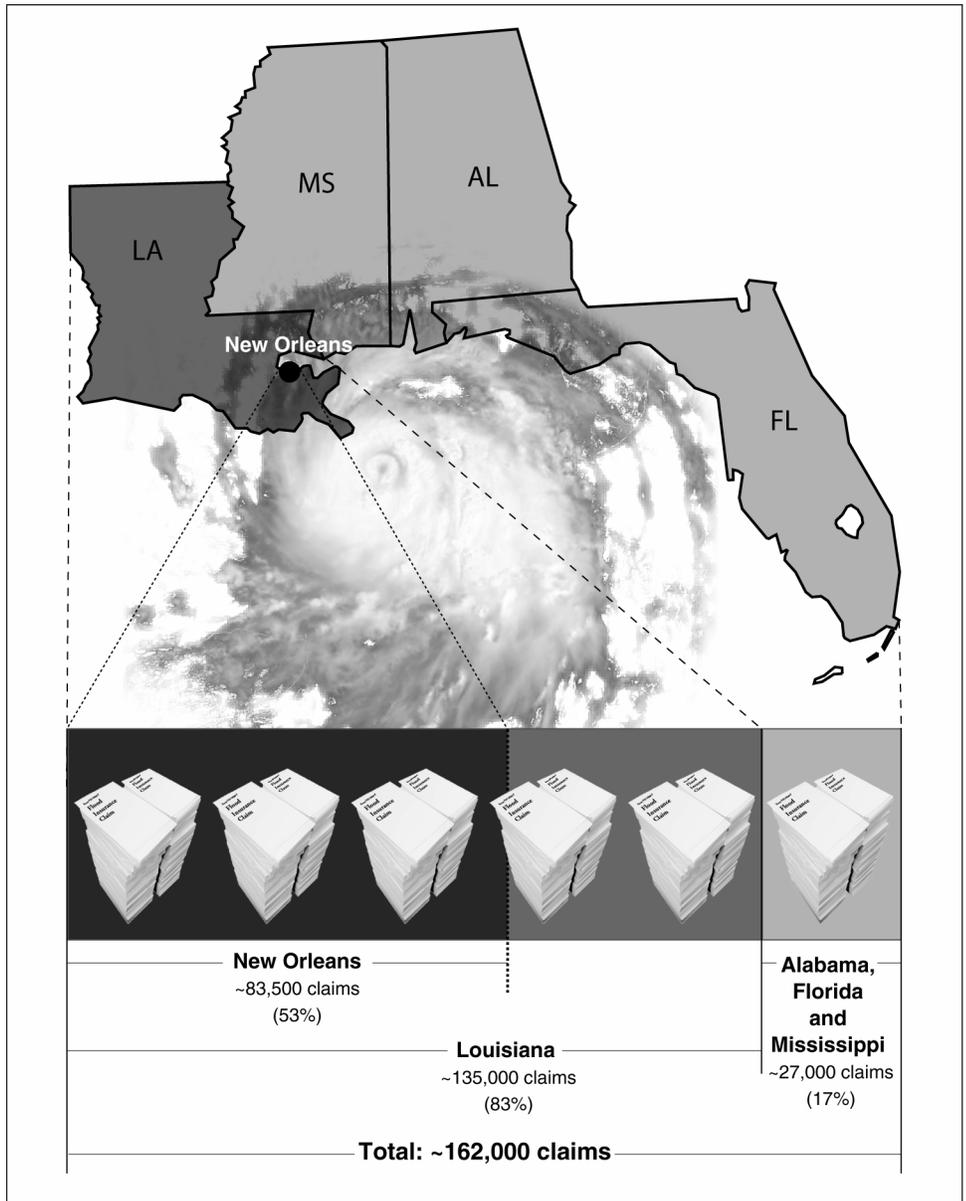
Until the 2004 hurricane season, FEMA had been generally successful in keeping the NFIP on sound financial footing, exercising its borrowing authority three times in the last decade when losses exceeded available fund balances. In each instance, FEMA repaid the funds with interest. According to FEMA officials, as of August 31, 2005, FEMA had outstanding borrowing of \$225 million with cash on hand totaling \$289 million. FEMA had substantially repaid the borrowing it had undertaken to pay losses incurred for the 2004 hurricane season, which, until Hurricane Katrina struck, had been the worst hurricane season on record for the NFIP. FEMA's current debt with the Treasury is almost entirely for payment of claims from Hurricanes Katrina and Rita and other flood events that occurred in 2005.

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### Most NFIP Loss Claims Were in Louisiana for Primary Residences in Special Flood Hazard Areas

As shown in figure 4, the majority of NFIP claims for flood damage from Hurricane Katrina were in Louisiana, and a large portion of the Louisiana Hurricane Katrina claims were in New Orleans.

**Figure 4: Hurricane Katrina Losses by Location**



Sources: GAO analysis of FEMA data, Map Resource and NASA.

Note: Number of claims rounded to the nearest thousand.

As of May 2006, the NFIP had paid about 162,000 claims for losses from flood damage from Hurricane Katrina in Alabama, Florida, Louisiana, and Mississippi. About 135,000 of these losses (about 83 percent) were in Louisiana. As of July 2006, about 83,500 Louisiana claims were made for property damage in the New Orleans area, where flood waters breached levees and floodwalls. Almost 9,000 additional NFIP claims, over 7,000 of them from Louisiana, were paid as a result of losses from Hurricane Rita.

Tables 1 and 2 provide a state-by-state breakdown of the number of paid losses, the number of losses paid at policy limits, and the average payment amounts per loss for Hurricanes Katrina and Rita, through May 2006.

**Table 1: Hurricane Katrina Loss Information by State (as of May 31, 2006)**

State	Number of paid losses	Amount paid (dollars in millions)	Number of losses paid at policy limits	Average loss payment
Alabama	4,915	\$257.4	633	\$54,374
Florida	5,382	109.4	19	20,319
Louisiana	134,829	12,635.3	66,140	93,713
Mississippi	16,939	2,362.2	11,593	139,454
Total	162,065	\$15,364.3	78,385	\$94,803

Source: GAO analysis of NFIP data.

**Table 2: Hurricane Rita Loss Information by State (as of May 31, 2006)**

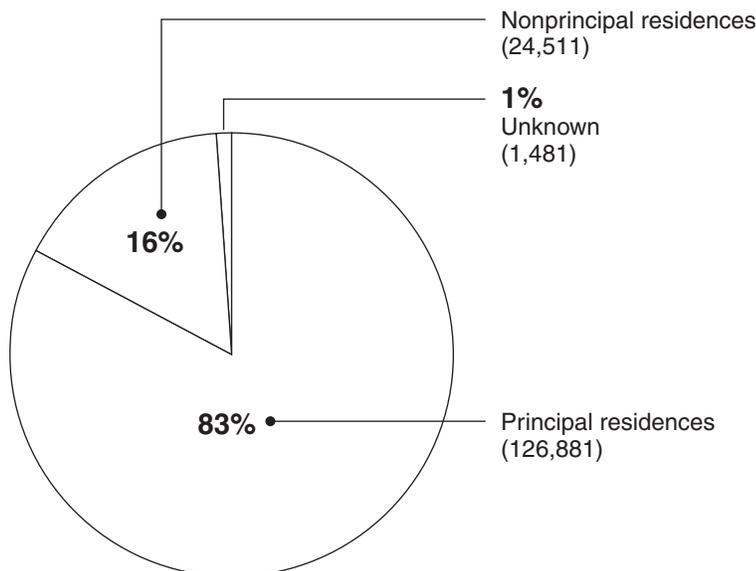
State	Number of paid losses	Amount paid (dollars in millions)	Number of losses paid at policy limits	Average loss payment
Louisiana	7,251	\$360.9	2,264	\$49,767
Texas	1,603	46.9	80	29,264
Total	8,854	\$407.8	2,344	\$46,055

Source: GAO analysis of NFIP data.

The majority of Hurricane Katrina and Rita paid losses were for flood damage to residences. About 96 percent of Hurricane Katrina paid losses and about 94 percent of Hurricane Rita paid losses were for residential properties including condominiums, while 4 percent and 6 percent of the paid losses, respectively, were for nonresidential properties including businesses and public buildings (i.e., schools and churches).

As shown in figures 5 and 6, the majority of paid losses for noncondominium residential properties were for principal residences.<sup>20</sup> About 16 percent of paid claims for residences damaged by Hurricane Katrina were nonprincipal residences, which include secondary homes. About 18 percent of paid losses for residences damaged by Hurricane Rita were for nonprincipal residences. See appendix II for detailed information on principal and nonprincipal residential paid losses by state.

**Figure 5: Hurricane Katrina Paid Losses for Principal and Nonprincipal Noncondominium Residential Properties (as of May 31, 2006)**

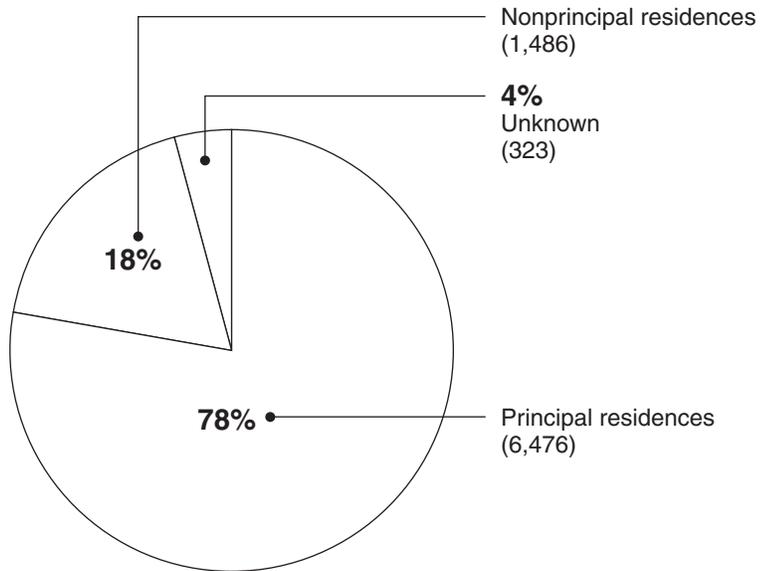


Source: GAO analysis of NFIP data.

Note: Nonprincipal residences include secondary homes. "Unknown" indicates that claims folders did not provide information on the type of residence that could be captured in the NFIP statistical database.

<sup>20</sup>Condominiums are not included because condominium associations are required to purchase policies to insure condominium buildings. Individual unit owners may elect to purchase separate policies for coverage on the contents of their units (i.e., furniture and electronic equipment).

**Figure 6: Hurricane Rita Paid Losses for Principal and Nonprincipal Noncondominium Residential Properties (as of May 31, 2006)**

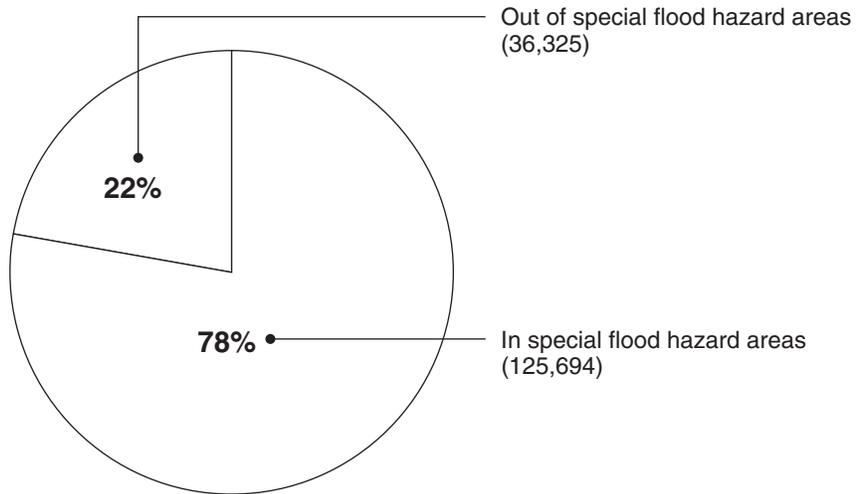


Source: GAO analysis of NFIP data.

Note: Nonprincipal residences include secondary homes. "Unknown" indicates that claims folders did not provide information on the type of residence that could be captured in the NFIP statistical database.

Most of the paid losses were for properties located within the special flood hazard areas where homeowners with mortgages from federally regulated lenders are required to purchase flood insurance on their dwellings for at least the amount of their outstanding mortgage. As shown in figure 7, about 78 percent of the paid losses for Hurricane Katrina through May 2006, were in special flood hazard areas subject to flooding or flooding and wave action where purchase of flood insurance is mandatory on properties with mortgages from federally regulated lenders. However, claims were also paid on 36,325 losses (about 22 percent) on properties outside of the special flood hazard areas where purchase of flood insurance is optional. As shown in figure 8, of 8,851 paid losses for Hurricane Rita through May 2006, 6,746 (about 76 percent) were in special flood hazard areas.

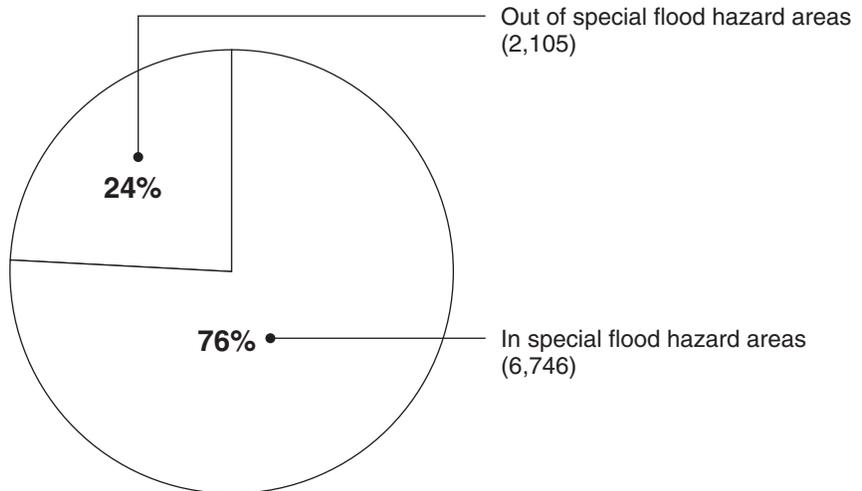
**Figure 7: Hurricane Katrina Claims Paid In and Out of Special Flood Hazard Areas (as of May 31, 2006)**



Source: GAO analysis of FEMA data.

Note: We could not determine the flood zone for 46 additional claims. However, we have determined that these data are sufficiently reliable for the purposes of our analysis.

**Figure 8: Hurricane Rita Claims Paid In and Out of Special Flood Hazard Areas (as of May 31, 2006)**

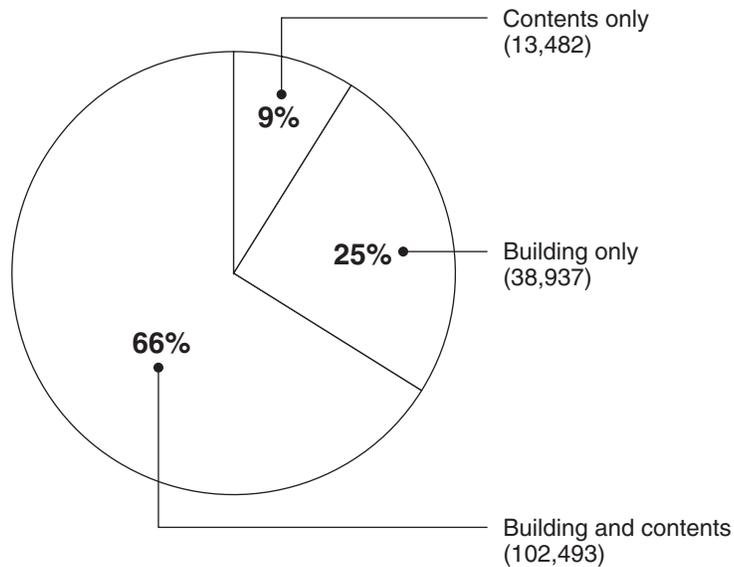


Source: GAO analysis of FEMA data.

Note: We could not determine the flood zone for 3 additional claims. However, we have determined that these data are sufficiently reliable for the purposes of our analysis.

While homeowners who live in specially designated flood hazard areas are required to purchase NFIP insurance on their dwellings at least for the amount of any federally regulated mortgage, the purchase of coverage for the home's contents, including furniture and personal property, is optional and may be purchased separately. NFIP policyholders who live in, for example, rental units, cooperatives, or condominium buildings may elect to purchase NFIP policies for contents coverage only. Figures 9 and 10 show that most paid Hurricane Katrina and Hurricane Rita residential losses were for both dwellings and contents. See appendix III for detailed information on residential paid losses for dwellings and contents by state.

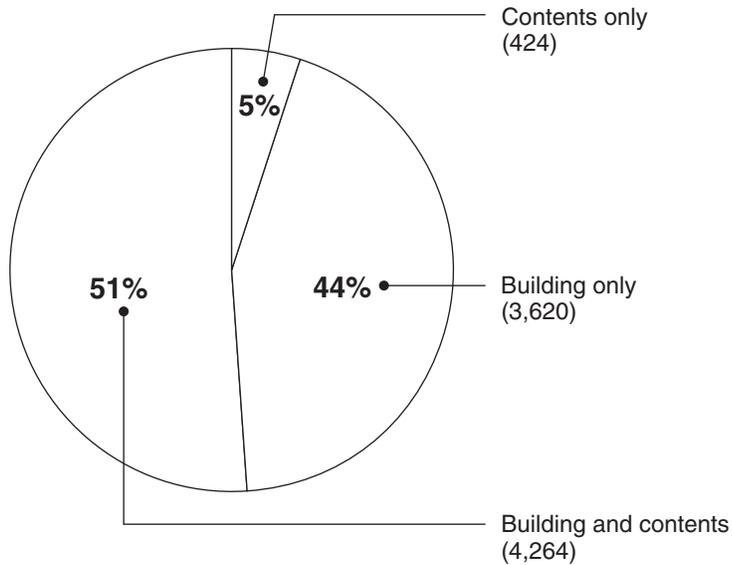
**Figure 9: Hurricane Katrina Paid Residential Losses for Dwellings and Contents (as of May 31, 2006)**



Source: GAO analysis of NFIP data.

Note: Includes condominiums

**Figure 10: Hurricane Rita Paid Residential Losses for Dwellings and Contents (as of May 31st, 2006)**



Source: GAO analysis of NFIP data.

Note: Includes condominiums

## FEMA and Private Sector NFIP Partners Were Challenged to Process a Record Number of Claims and Address the Needs of NFIP Claimants and Communities

The magnitude and severity of the damages from Hurricane Katrina closely followed by Hurricane Rita presented FEMA and its private sector NFIP partners with challenges to accurately process a record number of flood claims in a timely manner under adverse conditions and address other needs of NFIP claimants and communities.

## Officials Described Challenges to Processing Flood Claims

Challenges to addressing the needs of NFIP claimants after Hurricane Katrina were not limited to managing and processing a record volume of claims for damage in four Gulf Coast states. An official of FEMA's NFIP contractor described some of the adverse conditions faced by NFIP and

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write-your-own company officials and flood adjusters after Hurricane Katrina:

“A month after Hurricane Katrina, our adjusters couldn’t get to flooded properties because roadways were blocked by debris and houses were contaminated by flood waters. In many cases, adjusters could not even identify the houses they were trying to inspect because street signs were washed away and houses were piled on top on one another as a result of the storm surge. Adjusters went to some addresses only to find nothing left standing but the foundation. Making contact with claimants was in some cases impossible because they were scattered across the country and relocating frequently from one temporary address to another. In many cases, the documentation we normally use to adjust claims no longer existed. Claimants’ files at local insurance agencies, mortgage records, and other documents were gone in the flood.”

According to a representative of FEMA’s program contractor on-site in Hammond, Louisiana, about 8,000 adjusters were working on claims from Hurricanes Katrina and Rita at the high point, from October through December 2005. An owner of a firm that specializes in insurance claims adjustments for catastrophes described the problems he faced in getting adjusters to the affected areas. The majority of adjusters who worked under contract for this firm were staying in Mobile, Alabama, a 2½- to 3-hour drive from the New Orleans area. Highways were jammed, and lodging and fuel were in short supply. The business owner said that he bought more than 30 houses in the Mobile area, several tanker trucks of oil, and a gas station to meet adjusters’ housing and transportation needs.

Figure 11 shows photographs of flooded neighborhoods that illustrate some of the challenges faced by flood adjusters in getting to and identifying the heavily damaged houses they were assigned to inspect.

**Figure 11: Flood Adjusters Were Challenged to Get To and Identify Heavily Damaged Houses**



Source: FEMA.



Source: FEMA.



Source: FEMA.

Top left: Access to a flooded New Orleans neighborhood was limited for weeks after Hurricane Katrina. Top right: Homes that were heavily damaged by storm surge were difficult to locate and identify. Bottom: A bridge in Empire, La., was closed almost 60 days after Hurricane Katrina came through the area.

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## Over 95 Percent of Claims Were Closed within 9 Months with Relatively Few Complaints

Despite the large volume of claims and adverse conditions for settling them, the NFIP was successful in closing 92 percent of NFIP claims for Hurricane Katrina and 86 percent for Hurricane Rita by March 2006, about 7½ months after the storms struck. By May 2006, about 9 months after the storms, FEMA reported that over 95 percent of the Gulf Coast claims were closed. These time frames for closing claims are comparable to time frames for closing claims in other, smaller flood events. For example, in Florida, where the largest number of claims for flood damage were filed in the 2004 hurricane season, the NFIP closed about 88 percent of the 33,888 claims from Hurricanes Charley, Ivan, Frances, and Jeanne within 7 months and about 92 percent within 9 months.

Concerns from claimants about actions taken to settle their claims were relatively few in relation to the large number of claims filed. For example, as of April 2006, 13 appeals had been filed by claimants related to settlements of their claims for Hurricane Katrina damage, and no appeals had been filed on claims for damage from Hurricane Rita. In February 2006, FEMA's program contractor had received about 500 requests for special assist reinspections. These requests occur when claimants and insurance companies do not agree on aspects of the claims adjustment and ask for assistance in reaching a resolution. FEMA was not able to provide comparison data from prior years or updated information on the number of appeals filed after April 2006 and the number of special assist reinspections for Hurricanes Katrina and Rita after February 2006.

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## FEMA Approved the Use of Expedited and Square Foot Claims Adjustment Methods Unique to Hurricane Katrina

To try to assist NFIP policyholders despite many obstacles, FEMA approved expedited claims processing methods that were unique to Hurricanes Katrina and Rita. In some circumstances, claims could be adjusted without site visits by certified flood claims adjusters. For flooding from Lake Pontchartrain in New Orleans caused by the failure of the levees, FEMA allowed the use of aerial and satellite photography and flood depth data to identify structures that had been severely affected. If data on the depth and duration of the water in the building showed that it was likely that covered damage exceeded policy limits, the claim could be settled without a site visit by a claims adjuster. Similarly, for some other losses in Louisiana, Alabama and Mississippi, FEMA authorized claims adjustments without site visits where structures were washed off of their foundations by flood waters and square foot measurements of the dwellings were known. While FEMA authorized the use of these approaches, the write-your-own companies made the decision on whether they wished to use expedited processes to adjust claims. In addition, FEMA authorized the use of a square foot measurement methodology for

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homes that had been flooded off of their slabs, pilings, or posts. In those instances, damages could be calculated by a certified flood adjuster based on measurements of room dimensions and classification of building materials as high, medium, or low level, rather than a room-by-room, item-by-item calculation of loss amounts. FEMA authorized payments to its private insurance company partners of \$750 per expedited claim adjustment—a lower fee than would have been paid for a more time-consuming room-by-room, line-item-by-line-item visual assessment of flood damage.

According to the FEMA director of NFIP claims, about 17,200 claims for damage, mostly from Hurricane Katrina (about 11 percent of all Hurricane Katrina claims), were adjusted using expedited procedures. Although a relatively small number of claims were adjusted using expedited processes, officials of FEMA, its program contractor, representatives of two of the five private insurance companies we interviewed, and a flood claims adjusting service official said that having the option to do some expedited adjustments enabled the NFIP to keep up with demands for adjuster services and close the claims as quickly as it did.

Representatives of the three insurance companies we visited that did not use expedited processes to a significant extent said they did not do so for reasons including concerns over the accuracy of flood depth data, delays in the availability of flood depth data, and because their companies did not write homeowners' policies on the dwellings in question, they lacked necessary information (i.e., square foot measurements of the home) that were needed to process claims without site inspections.

According to the FEMA director of NFIP claims, two large write-your-own insurance companies developed models that were approved by FEMA for use in making square foot estimates of damage for some claims from Hurricanes Katrina and Rita instead of sending certified flood adjusters to the sites to assess and document damage room by room and item by item. According to the FEMA official, the square foot models paid claims based on the square footage of the property and a classification of the building materials as low, middle, or high level. For example, claims paid on a flooded high-level kitchen would be more than payments for a middle-level kitchen of the same square footage. If one or two high-end items were in a middle-level home (i.e., a custom front door or exotic hardwood floors), an adjustment to the middle-end rate would be made for those specific items. According to the official, the NFIP had experimented briefly with a much less sophisticated approach to square foot estimating about 10 years ago but had not used any form of claims adjusting since that time other

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than the traditional approach of sending a certified flood adjuster to the site to assess damage and estimate losses with required reports, work sheets, and photographs to document damage room by room and line item by line item.

The director of NFIP claims said that FEMA did not track the number of estimates done using the square foot method. He said that FEMA plans to examine the accuracy of the models carefully and consider using them for other catastrophic flooding events in the future. Because usage of the square foot method by the two companies with approved models was not carefully tracked during Hurricanes Katrina and Rita, FEMA paid the same fee for square foot adjustments as it did for regular line-item-by-line-item adjustments that took longer to perform and required more extensive documentation. However, the director of NFIP claims said that if the square foot methodology is approved for future use, the fee schedule paid for these adjustments would probably be lower than the current schedule for regular claims adjustments, with a resulting savings for the NFIP.

In addition to approving expedited and square foot claims adjusting methods, FEMA took several other actions to expedite claims adjustments and meet the needs of claimants in the aftermath of Hurricanes Katrina and Rita. These were actions that, according to officials, FEMA had also used to a more limited extent in prior large flood events. Specifically, FEMA

- waived the requirement that property owners furnish proof of loss statements that list their losses for all Hurricane Katrina and Rita claims,
- allowed telephone adjustments for some claims below \$25,000,
- established special toll-free telephone lines to assist policyholders who had questions about filing claims,
- liberalized adjuster training requirements to deploy more adjusters to flood-damaged areas, and
- authorized insurance companies and independent flood adjusting firms to use adjusters who did not meet FEMA's minimum flood certification requirements provided that they worked under the direction of seasoned adjusters until the company certified that they were trained.

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## NFIP Adjustment Process Will Continue with Claims for Help to Elevate or Remove Substantially Damaged Properties

As part of its floodplain management strategy, FEMA policies encourage the elevation or removal of damaged properties from the floodplain.<sup>21</sup> In addition to paying claims for flood damage, NFIP policies pay up to \$30,000 to owners of substantially damaged or repetitive loss properties for the cost of taking mitigation actions such as elevation, floodproofing, relocation or demolition, in order to comply with state or local floodplain management laws or ordinances. The payments are made under the increased cost of compliance (ICC) coverage of the standard flood insurance policy. As a first step to making claims for this coverage, adjusters are required to file preliminary damage assessment forms with FEMA for properties that may be substantially damaged. Figure 12 shows renovations in process on a New Orleans house that is being elevated to mitigate against future flood damage using ICC coverage to pay some of the costs.

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<sup>21</sup>A property is considered to be “substantially damaged” if the cost of repairing the property exceeds 50 percent of its market value (or a lower trigger if adopted locally), as determined by a state or community declaration.

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**Figure 12: A New Orleans House Is Elevated Using ICC Coverage to Pay Some Costs**



Source: FEMA.

This New Orleans house is in the process of being elevated above the base flood elevation adopted by the community after flooding from Hurricane Katrina. The homeowner received the ICC benefit included with his NFIP policy to cover some of the costs of elevating the house 11 feet to comply with the local floodplain management ordinance.

As of April 26, 2006, adjusters had completed almost 50,000 preliminary damage assessment forms for properties flooded by Hurricane Katrina and a little more than 1,000 forms for properties flooded by Hurricane Rita. Over 40,000 of the forms for damage in the two storms were for properties located in Louisiana. Through May 2006, FEMA had made ICC payments of about \$7 million on Hurricane Katrina and Rita claims. Anticipating a large number of ICC claims as a result of the 2005 hurricane season, FEMA increased the time frame for property owners to complete the mitigation actions from 2 years to 4 years after a state or community issued a substantial damage declaration. In an upcoming revision to the standard flood insurance policy, FEMA plans to make permanent the increase in time for property owners to complete work and receive ICC payments.

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## FEMA Issued Advisory Base Flood Elevations to Guide Rebuilding Efforts in the Aftermath of Hurricanes Katrina and Rita

In addition to approving new methods for expedited processing of some NFIP claims after Hurricane Katrina, FEMA also took new steps to guide communities' rebuilding efforts. For the first time, FEMA issued advisory guidance on coastal flood elevations that communities can use in the reconstruction process until more detailed data become available. According to FEMA officials, this guidance—called advisory base flood elevations—was necessary because a risk assessment showed that base flood elevations in effect for coastal Louisiana and Mississippi did not reflect the true risk to the areas from flooding. According to a FEMA official, FEMA expects to have updated rate maps for coastal areas by early 2007 so that communities can begin the process of considering to adopt them.

Accurate flood maps that identify the areas at high risk of flooding are the foundation of the NFIP, and the flood maps for some areas of the Gulf Coast affected by Hurricanes Katrina and Rita were out of date. The maps identify base flood elevation levels—the height at which there is a 1 percent chance of a flood occurring in a given year, also known as the 100-year flood. FEMA uses the 100-year flood as the standard for setting premium rates and requirements for NFIP.

Prior to Hurricanes Katrina and Rita, FEMA was conducting a coastal study of hurricane storm flooding as a part of its map modernization program.<sup>22</sup> According to a FEMA official, the agency was about to issue several new preliminary flood insurance rate maps in the Gulf Coast region when the storms hit. However, the storm surges from Hurricanes Katrina and Rita far exceeded the base flood elevations in many areas of the Gulf Coast, raising questions about the validity of the base flood elevations and current flood insurance rate maps. In response, FEMA conducted risk assessments using the most current and accurate flood risk data available. The analyses incorporated storm data from the past 35 years, including data from Hurricanes Katrina and Rita, tide (water level) gauge data, and other engineering studies. The analyses showed that base flood elevations on the flood insurance rate maps in effect for coastal Louisiana and Mississippi did not reflect the true risk from flooding because the elevations were between 1 and 9 feet too low. Also, the

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<sup>22</sup>FEMA embarked on a multiyear map modernization program to update the nation's flood maps at a cost in excess of \$1 billion. The goal of the program is to update the nation's inventory of flood insurance rate maps that identify areas of risk of flooding and determine flood insurance rates. They are also used for floodplain management and mitigation activities.

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analyses showed that higher storm surges and larger waves can be expected to spread farther inland than previously estimated because of land subsidence and the loss of the protective coastal barrier over the past 10 to 20 years. On completion of the risk analyses, FEMA issued advisory base flood elevation maps for 15 parishes in Louisiana and 3 counties in Mississippi that took into account the more accurate and up-to-date flood hazard data. (See app. III for a list of the communities for which the advisories were issued and the status of the communities' consideration of their adoption.)

FEMA cannot require communities participating in the NFIP to use the advisory base flood elevations. According to FEMA, it issued the advisories to parishes and counties, and individual communities within those jurisdictions can decide whether or not or to what extent they will adopt the guidance. For example, the City of Gulfport, Mississippi, adopted the advisories in September 2006 to protect citizens from future floods but extended the official adoption of the new elevations to November 1, 2006, to allow residents wishing to rebuild to less stringent elevation requirements in effect prior to the adoption of the advisories adequate time to secure building permits. The New Orleans city council approved FEMA's new advisories but made exceptions for properties in the French Quarter and other national historic structures in the city and those listed with the Historic Districts Landmarks Commission.<sup>23</sup> Lafourche Parish, Louisiana, rejected the advisory because the parish council considered some advisory map data to be wrong, determined that adopting the advisory would have a high negative economic impact on homeowners, and noted that the advisory information was intended to be only advisory and preliminary.

However, FEMA has provided incentives for individual homeowners and communities to rebuild using the advisory standards. For example, FEMA requires that rebuilding projects it funds, through public assistance or mitigation grants, be built to advisory standards. Similarly, FEMA grants for repairing and rebuilding public infrastructure such as schools, libraries, and police stations will not be available to communities unless they rebuild to advisory base flood elevations. NFIP policyholders who live in communities that have flood plain management standards that

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<sup>23</sup>Under the NFIP, communities may exempt historic buildings from NFIP substantial improvement and substantial damage requirements by issuing variances for historic structures.

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exceed the minimum standard are eligible for discounts on their premiums. ICC payments to NFIP claimants that take steps to reduce their risk from future flood damage will help cover the elevation of homes to the advisory base flood elevation if that standard is adopted by the community. FEMA has also warned communities that continued use of flood data on current flood insurance rate maps could result in residential and commercial buildings that will be vulnerable to flood damage because they will not be built high enough or have the structural integrity to resist flood forces that may be encountered in future large events.

According to a FEMA official, the agency expects to have updated, preliminary flood insurance rate maps for the coastal parishes and counties in Louisiana and Mississippi by early 2007. However, the maps will become effective only after a formal appeals process and community adoption; a process that normally takes a minimum of 2 years to complete. Once the new flood insurance rate maps are adopted, they will supersede all advisory base flood elevations issued by FEMA.

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## Results of Monitoring and Oversight of Claims Payments Were Inconclusive because FEMA Did Not Reinspect a Statistically Valid Sample of Claims

As in previous flood events, FEMA's primary method of monitoring and overseeing claims adjustments and addressing concerns from claimants was its quality reinspection program. As of August 2006, FEMA's program contractor had conducted quality assurance reinspections of 4,316 Hurricane Katrina and Rita claims. In addition, FEMA formed a special task force to reinspect an additional 1,696 claims that were adjusted using expedited processes. Because FEMA did not reinspect a random sample of all claims closed, as we recommended in October 2005, the results of the reinspections cannot be projected to a population larger than the 4,316 claims reinspected. As a result, FEMA is unable to determine the overall accuracy of the claims closed. FEMA's Deputy Director of the Mitigation Division said that FEMA agrees with our recommendation and plans to do quality reinspections in future flood events based on a random sample of the population of all claims. Neither FEMA nor its program contractor analyzed the overall results of the 4,316 quality reinspections for Hurricanes Katrina and Rita to identify the total number of payment errors and the magnitude of those errors. FEMA did not have a requirement that the overall results of the reinspections for flood events be analyzed. In our review of a statistically valid sample of 740 of the 4,316 reinspection reports, claims payment errors were identified in about 14 percent of the Hurricane Katrina reinspections of claims adjusted using regular processes, in about 1 percent of the reinspections of Hurricanes Katrina and Rita claims adjusted using expedited methods of claims adjustments, and 2 percent of Hurricane Rita

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reinspections of claims adjusted using regular processes. Because, in the past, FEMA has had neither an appropriate sampling methodology nor a requirement that an analysis be done of overall results of claims adjustments done after every flood event, we do not know how the error rates we identified compare to adjusting errors in reinspection reports for other smaller flood events.

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### General Adjusters and Disaster Analysts Did Quality Reinspections of About 2.5 Percent of All Claims and Additional Reinspections of Claims Adjusted Using Expedited Processes

To determine whether claims were correctly adjusted by the large cadre of adjusters deployed after Hurricanes Katrina and Rita, FEMA's program contractor conducted quality assurance reinspections of 4,316 Hurricane Katrina and Rita claims conducted from January to September 2006. The number of reinspections done was slightly smaller than the goal established by FEMA for the percentage of reinspections to be completed. However, FEMA officials told us in a briefing at the conclusion of our audit work that 5,198 reinspections had been completed. FEMA's director of NFIP claims said that the program contractor was to reinspect about 3 percent of all claims, about the same percentage of reinspections done after other flood events. In addition, the contractor was to review at least 10 percent of the expedited claims done by each insurance company that decided to use expedited processing procedures for some claims. Reinspection reports completed as of September 2006 represented about 2.5 percent of all Hurricane Katrina and Rita claims that were closed by May 2006. Reinspection reports were completed for just over 10 percent of the 17,200 claims closed using expedited processes.

The quality assurance reinspections are a standard oversight procedure after all flood events and are generally done by general adjusters who, in addition, are responsible for estimating damage from flood events, coordinating claims adjustment activities at disaster locations, and conducting adjuster training. When we did audit work for our October 2005 report, nine general adjusters were employed by FEMA's program contractor. Four general adjusters were on board after Hurricanes Katrina and Rita, according to the general adjuster in charge. According to FEMA, one reason for the loss of general adjusters was that several left to work as independent adjusters or for adjusting firms to earn higher pay adjusting claims for Hurricanes Katrina and Rita. To supplement the general adjuster workforce, FEMA's program contractor hired 22 temporary employees.

In addition to overseeing the regular quality reinspection program of 4,136 reinspections of Hurricanes Katrina and Rita claims adjusted using regular processes and expedited methods, FEMA formed a special task

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force of 15 adjusters and supervisors to review and reinspect additional claims closed using expedited methods. FEMA officials said that they took this action because the expedited methods had not been used to adjust claims in prior flood events, so they wanted to have additional information on the accuracy of payments made.

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### Quality Reinspection Program Does Not Rely on a Statistically Valid Sampling Methodology

FEMA did not adopt our October 2005 recommendation that it select the claims to be reinspected in its quality reinspection program using a random sample of the population of all claims.<sup>24</sup> Instead, according to the general adjuster in charge of Hurricanes Katrina and Rita, selection of claims to reinspect was based upon judgmental criteria including, among other items, the size and location of loss and complexity of claims. The general adjusters used their judgment to select what they thought were the more challenging claims adjustments for reinspection under the premise that if difficult adjustments are done accurately, more routine adjustments should be handled properly, as well.

The process the general adjuster described is a nonprobability sampling process rather than random sampling. In nonprobability sampling, staff selected a sample based on their knowledge of the population's characteristics. The major limitation of this type of sampling is that the results cannot be generalized to a larger population, because there is no way to establish, by defensible evidence, how representative the sample is. A nonprobability sample is therefore not appropriate to use to generalize about the population from which the sample is taken.

After discussion, FEMA agreed with GAO's recommendation that it implement an approach for random sampling. The Deputy Director of FEMA's Mitigation Division said that FEMA plans to do quality reinspections in future flood events based on a random sample of the universe of all claims. The official advised that FEMA was not able to implement the October 2005 recommendation in the aftermath of Hurricanes Katrina and Rita because other priorities to meet the needs of claimants and communities took precedence.

Because the judgmental criteria were used in selecting reinspections to be done, the results of FEMA's NFIP quality reinspection program for Hurricanes Katrina and Rita cannot be projected to a larger universe than

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<sup>24</sup>See [GAO-06-119](#).

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the claims adjustments sampled. As a result, FEMA is unable to determine the overall accuracy of claims settled for these flood events—an action that is necessary to meet GAO’s internal control standard that FEMA have reasonable assurance that program objectives are being achieved and its operations are effective and efficient.<sup>25</sup>

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### Limited Information Available on the Overall Results of the Quality Reinspections

Of FEMA’s 4,316 claims reinspections, 2,565 (about 59 percent) were for claims adjustments done using regular processes that included on-site visits by a certified flood adjuster to assess damages, while 1,751 (about 41 percent) were reinspections of claims adjusted using the expedited methods that FEMA authorized to settle some claims at policy limits without site visits by flood adjusters. FEMA’s program contractor did not analyze the overall results of its quality reinspection program for Hurricanes Katrina and Rita, another action that is necessary to meet our internal control standard that FEMA have reasonable assurance that program objectives are being achieved and its operations are effective and efficient. FEMA’s director of NFIP claims said that FEMA does not generally require the program contractor to prepare and analyze reports of the overall results of quality reinspections after flood events. According to officials of FEMA and its program contractor, in addition to preparing written reports of each quality assurance reinspection, general adjusters discuss the results of the reinspections they perform with insurance company officials that process the claims. If a general adjuster determines that an expense was allowed that should not have been covered, the company is to reimburse the NFIP. If a general adjuster finds that the private sector adjuster missed a covered expense in the original adjustment, the general adjuster will take steps to provide additional payment to the policyholder. According to officials of FEMA and its program contractor, quality assurance reinspections are forwarded from general adjusters to the program contractor, where results of reinspections are to be aggregated in a reinspection database and the resolution of overpayments and underpayments is tracked.

According to the FEMA director of NFIP claims, a special task force of adjusters and supervisors reinspected 1,696 expedited claims from Hurricane Katrina in addition to the reinspections conducted in the quality reinspection program and found a total of 81 erroneous payments (about 5 percent). FEMA will take action to recover overpayments of claims

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<sup>25</sup>GAO, *Policy Manual* (Washington, D.C.: Jan. 1, 2004).

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where it is appropriate to do so. The official also stated that a report on the results of the task force review was being prepared, but it was not completed during the course of our review. We did not analyze data from the special task force as part of our review of a sample of quality reinspection reports.

Because the NFIP's quality reinspection program does not rely on a statistically valid sampling methodology, like FEMA, we are unable to project the results of our reviews of 740 reinspection reports to the population of all claims closed. However, because our sample is a probability sample of all 4,316 reinspections claims, are able to project our estimates to this population of claims reinspections.

Our review of 320 of the quality reinspection reports done for Hurricane Katrina regular process claims found that reinspectors identified problems in 119 instances (about 37 percent).<sup>26</sup> In most instances where quality reinspections identified problems with the original claims adjustments, reinspectors determined that the claims payment amounts were correct but that files did not meet NFIP standards (e.g., they did not include all supporting documentation). However, 44 of the 320 quality reinspection reports we reviewed for Hurricane Katrina claims adjustments that used regular processes (about 14 percent) identified claims overpayments or underpayments. Payment errors identified in our review included 8 underpayments that ranged from more than \$131,000 to \$543 and 36 overpayments that ranged from \$65,000 to \$86. For the expedited process reinspection reports, we identified problems in about 12 percent (39 of 320) reports we reviewed. However, reinspectors identified erroneous overpayments in only 4 of these instances (about 1 percent). These payment errors were all overpayments that ranged from \$40,000 to \$80,000. On the basis of our review of 100 Hurricane Rita reinspections, we estimate that about 2 percent of the reinspections identified erroneous payments. These payment errors were between \$9,000 and \$10,000. Because, in the past, FEMA has had neither an appropriate sampling methodology nor a requirement for an overall analysis claims adjustment done after every flood event, we do not know how the error rates we identified compare to adjusting errors identified in reinspections

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<sup>26</sup>These estimates are based on a probability sample and are subject to sampling error. For Hurricane Katrina regular process reinspections and Hurricanes Katrina and Rita claims processed using expedited methods, we are 95 percent confident that the actual percentage is within +/- 5 percentage points of our estimates. More information about precision of estimates is contained in appendix I.

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of claims from other smaller flood events. See appendix IV for the complete results of our review of 740 quality reinspection reports for claims adjustments after Hurricanes Katrina and Rita.

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## FEMA Has Made Progress Implementing NFIP Program Changes in the Flood Insurance Reform Act of 2004

Since we last reported in October 2005, FEMA has moved forward on implementation of the Flood Insurance Reform Act of 2004.<sup>27</sup> However, there is still progress to be made. Among other things, the act mandated FEMA to (1) develop supplemental materials for explaining NFIP coverage and the claims process to policyholders when they purchase and renew policies; (2) establish, by regulation, an appeals process for claimants; and (3) establish minimum training and education requirements for flood insurance agents in cooperation with the insurance industry, state insurance regulators, and other interested parties and publish the requirements in the *Federal Register*.<sup>28</sup> The statutory deadline for the three mandates was December 30, 2004. The act also authorized FEMA to create a pilot program to provide financial assistance to states and communities to carry out activities including elevating and demolishing structures that have suffered severe and repeated damage from flooding.<sup>29</sup> The act authorized the use of funds from the National Flood Insurance Fund for the pilot program for fiscal years 2005 through 2009. FEMA has fully implemented the first two requirements to establish notifications on coverage to policyholders and an appeals process for claimants. With regard to the training and education requirements, FEMA published training and education requirements in the *Federal Register*, stating that it intended to implement the standards through existing state licensing schemes for insurance agents. Though FEMA has taken a number of actions to improve the training and education of agents that sell NFIP policies, only 15 states implemented mandatory training and education requirements as of October, 2006 and as we reported in October 2005, FEMA has not established how or when states are to begin imposing education and training requirements. Finally, FEMA has not created a pilot program to mitigate damage to severe repetitive loss properties.

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<sup>27</sup>See [GAO-06-119](#).

<sup>28</sup>Pub. L. No. 108-264, §§ 202, 203, 204 (codified at 42 U.S.C. § 4011 note (2004)) (requiring FEMA to develop informational materials); Pub. L. No. 108-264, § 205 (codified at 42 U.S.C. § 4011 note (2004)) (requiring FEMA to establish appeals process); Pub. L. No. 108-264, § 207 (codified at 42 U.S.C. § 4011 note (2004)) (requiring FEMA to establish and publish minimum training and education requirements).

<sup>29</sup>Pub. L. No. 108-264 at § 102 (codified at 42 U.S.C. § 4102a (2004)).

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## Informational Materials to Explain Coverage and the Claims Process Are Completed

For purposes of explaining coverage and the claims process to policyholders, the Flood Insurance Reform Act of 2004 required FEMA to develop three types of informational materials. The required materials are (1) supplemental forms explaining in simple terms the exact coverage being purchased; (2) an acknowledgment form that the policyholder received the standard flood insurance policy and any supplemental explanatory forms, as well as an opportunity to purchase coverage for personal property; and (3) a flood insurance claims handbook describing the process for filing and appealing claims. FEMA officials said that acknowledgment forms and new insurance program forms to explain coverage to policyholders when they purchase and renew their insurance were final as of September 2005. FEMA posted a flood insurance claims handbook, dated July 2005, on its Web site in September 2005. The handbook contains information on anticipating, filing, and appealing a claim. The Director of the FEMA Mitigation Division, which oversees the NFIP, said that FEMA distributed the NFIP Summary of Coverage and Flood Insurance Claims Handbook to help policyholders affected by Hurricane Katrina through the claims process. The materials were available in disaster recovery and flood response offices and were distributed in town meetings. In addition, according to a representative of FEMA's program contractor on-site in Hammond, Louisiana, some flood adjusters provided copies of the documents to claimants to help to explain the processes for filing claims and resolve any disagreements about the claims settlement.

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## Formal Appeals Process in Place

An appeals process that FEMA officials described as informal was in place for claimants after Hurricane Katrina and was described in the Flood Insurance Claims Handbook that FEMA posted on its Web site in September 2005. As we have stated in this report, 13 appeals were filed by claimants related to settlements of their NFIP claims as a result of Hurricane Katrina damage, and no appeals were filed for damage resulting from Hurricane Rita, as of April 2006. To establish a formal appeals process, FEMA published an interim rule in the *Federal Register* that became effective in June 2006.<sup>30</sup> Comments made in the Additional Views section of the Senate report on the Flood Insurance Reform and Modernization Act of 2006, a bill pending in Congress as of November 2006, outlined concerns that the rule was not specific on the structure of

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<sup>30</sup>See Appeal of Decisions Relating to Flood Insurance Claims, 71 Fed. Reg. 30,294 (May 26, 2006).

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## Some States Have Established Minimum Education and Training Requirements

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the appeals process. After a public comment period, a final rule was published on October 13, 2006.<sup>31</sup> The final rule included more specific elements on the structure of the appeals process in the final rule than were contained in the interim rule. For example, the final rule stated that FEMA will provide policyholders with an acknowledgment of receipt of an appeal, which will also provide the policyholder with a point of contact within FEMA to get information on the status of the appeal, and that FEMA is subject to a 90-day deadline to resolve appeals and issue a written appeal decision to the policyholder and insurer. The final regulation also provided examples of the types of documentation that policyholders should include in their appeals.

With respect to the requirement that FEMA establish minimum education and training requirements for agents who sell NFIP policies, the Flood Insurance Reform Act of 2004 requires FEMA, in cooperation with the insurance industry, state insurance regulators, and other interested parties, to establish minimum training and education requirements for all insurance agents who sell flood insurance policies and to publish the requirements in the *Federal Register*. On September 1, 2005, FEMA published a *Federal Register* notice in response to this requirement.<sup>32</sup> In the notice, FEMA stated that rather than establish separate and perhaps duplicative requirements from those that may already be in place in the states, it had chosen to work with the states to implement NFIP requirements through already established state licensing schemes for insurance agents. To that end, FEMA provided suggested language for state legislation to require a preclicensing demonstration of knowledge of flood insurance and a onetime, 3-hour continuing education course requirement for existing licensees. FEMA further provided a course outline for flood insurance agents, which consisted of eight sections: an NFIP Overview; Flood Maps and Zone Determinations, Policies and Products Available, General Coverage Rules, Building Ratings, Claims Handling Process, Requirements of the Flood Insurance Reform Act of 2004, and Agent Resources. FEMA also offered incentives to agents who completed NFIP training to encourage adoption of the minimum standards.

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<sup>31</sup>See Appeal of Decisions Relating to Flood Insurance Claims, 71 Fed. Reg. 60,435 (Oct. 13, 2006)

<sup>32</sup>See Flood Insurance Training and Education Requirements for Insurance Agents, 70 Fed. Reg. 52,117 (Sept. 1, 2005).

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For fiscal years 2006 and 2007, FEMA adopted performance measures for meeting “the objective of the mandate that agents selling flood insurance are trained and provide good information to consumers.” The performance measures center on FEMA activities to encourage agent training activities, but do not establish milestones for states to implement the minimum training requirements. Specifically, the performance measures are to

- increase by 7 percent over the previous year the number of insurance agents who complete the NFIP Bureau’s flood insurance training, either live or online;
- submit a new online training module to states for continuing education credit approval, with approval by 40 states by fiscal year 2008;
- encourage write-your-own companies to do their part to ensure their agents are sufficiently trained, and
- foster state adoption of mandatory agent training requirements through continued communication with departments of insurance, offering technical assistance, and so forth.

In working toward the final performance measure, FEMA held meetings and conferences with state legislators and insurance regulators, as well as insurance company officials, and worked with the National Association of Insurance Commissioners to develop a model bulletin that state insurance commissioners may issue to implement the minimum training requirements.<sup>33</sup>

As of October 2006, only 15 states had established minimum training and education requirements for insurance agents that sell NFIP policies.<sup>34</sup> Two states had issued advisory notices, and 1 state had established standards for a continuing education course in flood insurance but had not made the course mandatory. As we reported in October 2005, FEMA has not developed milestones for state adoption of minimum training and education requirements. See appendix V for a listing of the state actions taken.

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<sup>33</sup>NAIC Model Bulletin, available at [http://www.naic.org/Releases/2006\\_docs/flood\\_bulletin.htm](http://www.naic.org/Releases/2006_docs/flood_bulletin.htm).

<sup>34</sup>Ten of the 15 states that implemented minimum training standards did so through bulletins or advisory opinions, which provide guidelines for insurance agents.

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## FEMA Has Not Established a Pilot Program to Mitigate Damage to Severe Repetitive Loss Properties

As of October 2006, FEMA had not implemented the pilot program authorized by the act to help reduce the inventory of NFIP properties that have sustained repeated severe flood losses. As noted in the report of the Senate Committee on Banking, Housing, and Urban Affairs accompanying the legislation, an important purpose of the act is to address the problem of severe repetitive loss properties, which are properties that have been flooded numerous times and are thus a financial drain on the NFIP.<sup>35</sup> The act authorizes financial assistance to states and communities that decide to participate in the pilot program to carry out mitigation activities that reduce flood damages to severe repetitive loss properties.<sup>36</sup> The act authorizes the transfer of up to \$40 million per fiscal year for fiscal years 2005 through 2009 from the NFIP Fund for the pilot program, and funds for the program were appropriated in fiscal year 2006. States and communities may use funds under this program for the mitigation of severe repetitive loss properties. Mitigation actions may include purchase, relocation, demolition, elevation, or flood-proofing structures, as well as minor physical localized flood control projects. Funds may also be used by states and communities to purchase severe repetitive loss properties. FEMA officials noted that they had made progress in developing the program guidance and implementing regulations for the pilot program and plan to combine the fiscal years 2006 and 2007 appropriations and begin funding projects under the pilot program in fiscal year 2007.

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## Conclusions

By the measures of number of claims filed, amount of claims paid, losses per claim, and debt incurred, Hurricane Katrina was an unprecedented event for the NFIP that created challenges to process a record number of claims and address needs of claimants and communities that experienced grave losses. FEMA approved new methods of adjusting some Hurricane Katrina and Rita claims, issued advisory opinions to aid in rebuilding after these flood events, and took other actions to address the needs of NFIP claimants and communities.

However, the importance of FEMA taking additional actions to enhance the value of its monitoring and oversight processes is also illustrated in the

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<sup>35</sup>S. Rep. No. 108-262, at 2-3 (2004).

<sup>36</sup>The act defines single-family severe repetitive loss properties as those for which four or more separate NFIP claims payments exceeding \$5,000 have been made and the cumulative amount of the claims exceeds \$20,000, or at least two separate claims payments have been made which, cumulatively, exceed the value of the property. 42 U.S.C. § 4102a(b)(1) (2004).

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aftermath of Hurricanes Katrina and Rita. Not only did these flood events involve billions more dollars and hundreds of thousands more claims for the NFIP than any previous flood event since the program's inception, but they also involved new claims-processing methods that, if proven to result in accurate claims adjustments, could lower NFIP payments for claims adjustments as compared to fees paid for the more time-consuming room-by-room, line-item-by-line-item visual assessments of flood damage that the NFIP had exclusively relied upon for all prior flood events. FEMA's current use of quality assurance reinspections to discuss individual results and specific adjustment errors with insurance company officials and seek reimbursements for overpayments is too limited to meet our internal control standard that it have reasonable assurance that program objectives are being achieved and its operations are effective and efficient. For future flood events, when FEMA conducts its quality assurance reinspection program for claims adjustments using the statistically valid sampling methodology we previously recommended, the agency will be well positioned to broaden the scope of its analyses to determine the overall results of claims adjustments done for each future flood event, including the number and type of claims adjustment errors that occurred.

FEMA made progress in implementing provisions of the Flood Insurance Reform Act of 2004. However, our recommendation that FEMA establish milestones for meeting provisions of the act remains open. In October 2005, we recommended that FEMA develop a documented plan with milestones for ensuring that agents that sell NFIP policies meet minimum training and education requirements. FEMA has taken a number of actions, including outreach to the states, to encourage the implementation of minimum training standards. However, given the somewhat slow progress among states to adopt mandatory training requirements, we continue to think that FEMA should elaborate on the state implementation performance measure by developing a documented plan with milestones for state adoption of minimum training and education requirements and our recommendation related to the minimum training and education requirements remains open.

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## Recommendation for Executive Action

To strengthen and improve FEMA's monitoring and oversight of the NFIP, including ensuring that claims payments are accurately determined, we are recommending that for future flood events when FEMA implements our prior recommendation to do quality assurance reinspections of a statistically valid sample of claims adjustments, the Secretary of the Department of Homeland Security also direct the Under Secretary of Homeland Security, FEMA, to take the following action:

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- Analyze the overall results of claims adjustments done for each future flood events to determine the number and type of claims adjustment errors made and to help determine whether new, cost-efficient methods for adjusting claims that were introduced after Hurricane Katrina are feasible to use after other flood events.

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## Agency Comments and Our Evaluation

On December 8, 2006, DHS provided written comments on a draft of this report. DHS agreed with our recommendation to improve its quality reinspection program and stated that it was revising its guidance accordingly and would use the recommended sampling and reporting procedures in future flood events.

DHS reiterated a comment made in FEMA's review of our October 2005 report that we did not review all of the controls and processes that FEMA has in place to provide oversight for the NFIP. Most of the additional oversight and management processes and controls that FEMA has in place are for financial management—an area not included in the scope of our work. Our work focused on program implementation and oversight in the aftermath of Hurricanes Katrina and Rita. During our review, FEMA managers described the quality assurance claims reinspection program as the primary method for overseeing the accuracy of claims adjustments for these flood events. As we have noted in this report, we have work under way to examine the cost of operating the NFIP, including fees paid for the services of private insurance companies and claims adjusters. For that report, to be issued in 2007, we plan to examine the NFIP's financial management and controls.

DHS also provided information on how it determines the number of claims to be reinspected in the NFIP's quality reinspection program and additional information on its implementation of the requirement of the Flood Insurance Reform Act of 2004 to establish minimum training and education requirements for all insurance agents who sell flood insurance policies and to publish the requirements in the *Federal Register*.

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We are sending copies of this report to the Secretary of the Department of Homeland Security, the Director of the Federal Emergency Management Agency and other interested parties. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>. Please contact William Jenkins at (202) 512-8757 or [jenkinswo@gao.gov](mailto:jenkinswo@gao.gov) if you or your staff have any questions concerning this report. Contact points for

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our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VII.

A handwritten signature in black ink, reading "William O. Jenkins, Jr.", with a long horizontal flourish underneath.

William O. Jenkins, Jr.  
Director, Homeland Security and Justice Issues

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*List of Congressional Committees:*

The Honorable Richard Shelby  
Chairman

The Honorable Paul Sarbanes  
Ranking Minority Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Michael Oxley  
Chairman

The Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives

The Honorable Susan M. Collins  
Chairman

The Honorable Joseph I. Lieberman  
Ranking Minority Member  
Committee on Homeland Security and Governmental Affairs  
United States Senate

The Honorable Peter T. King  
Chairman

The Honorable Bennie G. Thompson  
Ranking Minority Member  
Committee on Homeland Security  
House of Representatives

The Honorable Tom Davis  
Chairman

The Honorable Henry A. Waxman  
Ranking Minority Member  
Committee on Government Reform  
House of Representatives

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# Appendix I: Scope and Methodology

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To describe the impact of Hurricanes Katrina and Rita on the National Flood Insurance Program (NFIP) and the extent of the losses paid by location and property type, we reviewed congressional actions to increase the NFIP borrowing authority, and we interviewed the Director, Deputy Director, and other officials of the Federal Emergency Management Agency's (FEMA) Mitigation Division on the actions they took to estimate the amount of funds they needed to borrow from the U.S. Treasury to cover claims from Hurricanes Katrina and Rita and other 2006 flood events. We compared claims payments for losses from Hurricanes Katrina and Rita to payments for losses from past flood events. We also analyzed statistical data from the NFIP data system on claims payments for Hurricanes Katrina and Rita. We analyzed the data on losses paid by state, for principal and nonprincipal residential properties, within and outside of special flood hazard areas, and by type of coverage (i.e., building, contents, or both building and contents). We updated our reliability assessment of the statistical data base reported in October 2005 by interviewing database managers to discuss any system changes that would have an impact on data reliability and by replicating statistical analyses by the NFIP to determine their accuracy.<sup>1</sup> We determined that the database was sufficiently reliable for our reporting purposes. We did our analyses and reliability testing of FEMA statistical data that were current through May 31, 2006, when FEMA reported that over 95 percent of Hurricane Katrina and Rita claims were closed.

To describe the challenges FEMA and its private sector partners faced and the results of their efforts to process flood claims resulting from Hurricanes Katrina and Rita and address the needs of NFIP claimants and communities, we interviewed headquarters and field officials of FEMA and its program contractor. We also conducted semistructured interviews based on our judgment with insurance industry officials involved in the recovery effort and visited areas impacted by Hurricane Katrina in New Orleans, Louisiana, and Bayou La Batre, Alabama. Interviewees included the owner of a firm that specializes in insurance claims adjustments for catastrophes, representatives of the three insurance companies that closed the largest number of Hurricane Katrina and Rita NFIP claims, and a representative of an insurance company that was not a major NFIP insurer for the Gulf Coast claimants but did process some claims. Their views are not representative of the universe of all insurance industry officials involved in the flood recovery effort. We also analyzed statistical data on

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<sup>1</sup>See [GAO-06-119](#).

the number of appeals filed by claimants and requests made for reinspections by FEMA's program contractor to assist claimants and insurance companies in reaching resolutions on disputes. We reviewed documentation and talked with officials about new, expedited methods of claims processing FEMA approved. We examined preliminary data on claims that may be filed for coverage under the standard flood insurance policy for up to \$30,000 for some property owners to take actions to reduce their risk of future flood damage. Finally, we examined documentation and interviewed FEMA officials on the status of efforts to provide guidance to communities and property owners to assist in recovery and rebuilding efforts and reviewed documentation on the status of communities' actions to adopt FEMA's advisory base flood elevation standards.

To assess FEMA's role in monitoring and overseeing the NFIP and the results of that oversight, we interviewed officials of FEMA and its program contractor who were involved in the quality assurance reinspections of claim adjustments done for Hurricanes Katrina and Rita and documented the number of reinspections performed and the methodology used to select claims for reinspection. We reviewed documentation of FEMA's procedures for monitoring and overseeing claims adjustments. We observed a disaster analyst for FEMA's program contractor performing several quality assurance reinspections in Bayou La Batre. We followed up on the status of our prior recommendation for improvements in the quality assurance reinspection program and discussed actions taken or planned to implement it.<sup>2</sup> We selected a statistically valid sample of 740 reinspection reports done for Hurricanes Katrina and Rita to review to determine, among other things, errors that were identified in the claims adjustments. Using a data collection instrument, we reviewed the results of these randomly selected reinspection reports of Hurricane Katrina and Rita claims to determine whether reinspectors identified errors, including overpayment, underpayments, or adjustments that did not meet NFIP standards (i.e. did not contain appropriate documentation).

Table 3 shows the number of quality assurance reinspection reports of claims adjustments done using regular processes we examined, including site visits by flood adjusters and expedited methods FEMA approved for some Hurricane and Rita claims.

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<sup>2</sup>See [GAO-06-110](#).

**Table 3: Number of FEMA Quality Assurance Reinspection Reports and the Sample We Reviewed, by Process Type and Flood Event**

<b>Process type/flood event</b>	<b>Number of FEMA reinspection reports</b>	<b>Number of reinspection reports we reviewed</b>
Regular process claims adjustments for Hurricane Katrina	2,258	320
Regular process claims adjustments for Hurricane Rita	307	100
Expedited methods for Hurricanes Katrina and Rita	1,751	320
<b>Total</b>	<b>4,316</b>	<b>740</b>

Source: GAO.

To assess the status of FEMA’s efforts to implement provisions of the Flood Insurance Reform Act of 2004 after Hurricanes Katrina and Rita, we interviewed officials and examined documentation of the actions FEMA took. We also analyzed FEMA’s actions to determine whether they met the legal requirements of the act.

We conducted our work in accordance with generally accepted government auditing standards from December 2005 through November 2006.

# Appendix II: Statistical Information on NFIP Claims Paid for Hurricanes Katrina and Rita

**Table 4: Hurricane Katrina Principal and Nonprincipal Residential Paid Losses by State (as of May 31, 2006)**

State	Principal residence	Nonprincipal residence	Unknown
Alabama	2,350	1,904	13
Florida	4,497	584	0
Louisiana	107,960	18,739	1,263
Mississippi	12,074	3,284	205
<b>Total noncondominium residential</b>	<b>126,881</b>	<b>24,511</b>	<b>1,481</b>

Source: GAO analysis of FEMA data.

**Table 5: Hurricane Rita Principal and Nonprincipal Residential Paid Losses by State (as of May 31, 2006)**

State	Principal residence indicated	Nonprincipal residence indicated	Unknown
Louisiana	5,191	1,287	313
Texas	1,285	199	10
<b>Total noncondominium residential</b>	<b>6,476</b>	<b>1,486</b>	<b>323</b>

Source: GAO analysis of FEMA data.

**Appendix II: Statistical Information on NFIP  
Claims Paid for Hurricanes Katrina and Rita**

**Table 6: Hurricane Katrina Paid Residential Losses for Dwellings and Contents by State (as of May 31, 2006)**

<b>State</b>	<b>Coverage for dwelling only</b>	<b>Coverage for contents only</b>	<b>Coverage for dwelling and contents</b>
Alabama	2,606	90	1,861
Florida	2,202	98	2,913
Louisiana	30,404	12,876	85,867
Mississippi	3,725	418	11,852
<b>Total</b>	<b>38,937</b>	<b>13,482</b>	<b>102,493</b>

Source: GAO analysis of FEMA data

**Table 7: Hurricane Rita Paid Residential Losses for Dwellings and Contents by State (as of May 31, 2006)**

<b>State</b>	<b>Coverage for dwelling only</b>	<b>Coverage for contents only</b>	<b>Coverage for dwelling and contents</b>
Louisiana	3,117	368	3,326
Texas	503	56	938
<b>Total</b>	<b>3,620</b>	<b>424</b>	<b>4,264</b>

Source: GAO analysis of FEMA data.

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# Appendix III: Parishes and Counties Where FEMA Issued Advisory Flood Elevation Guidance

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**Table 8: Parishes and Counties Where FEMA Issued Advisory Flood Elevation Guidance**

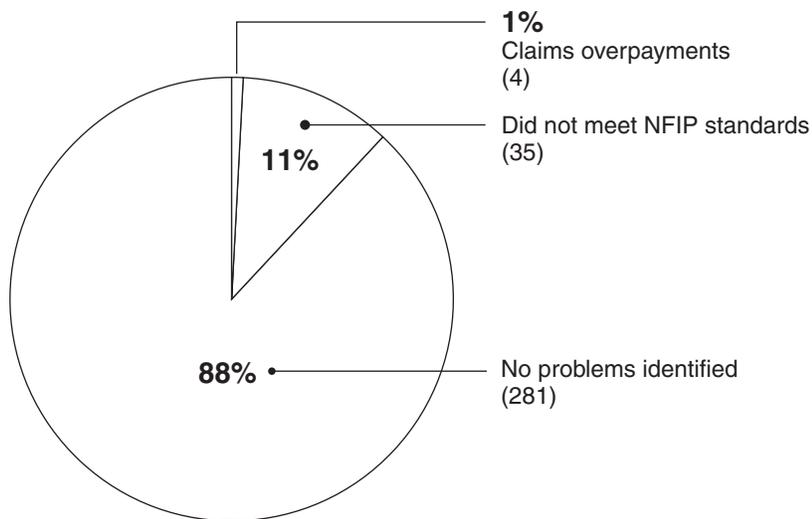
<b>Louisiana parishes</b>	Calcasieu, Cameron, Iberia, Jefferson, Lafourche, Orleans, Plaquemines, St. Bernard, St. Charles, St. John the Baptist, St. Mary, St. Tammany, Tangipahoa, Terrebonne, Vermillion
<b>Mississippi counties</b>	Hancock, Harrison, Jackson

Source: FEMA.

At the time of our review, 11 of the 15 Louisiana parishes where FEMA issued advisory flood elevation guidance had adopted FEMA’s advisories. Two parishes, St. John the Baptist and Lafourche, had decided not to adopt the advisories; and two others, Plaquemines and St. Bernard, were considering them. The Lafourche Parish council rejected the advisory because it considered some advisory map data to be wrong and determined that adopting the advisory would have a high negative economic impact on homeowners. The council also noted that the advisory information was intended to be only advisory and preliminary. Fourteen cities within the 3 Mississippi counties where FEMA issued advisory flood elevation guidance had taken some new action to guide rebuilding efforts.

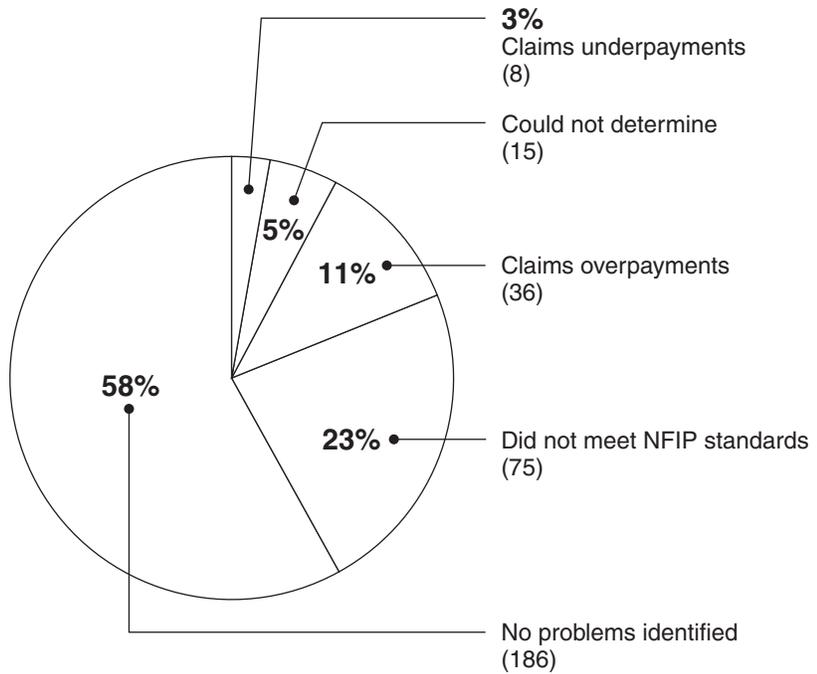
# Appendix IV: Results of GAO Review of a Random Selection of Reinspection Reports for Hurricanes Katrina and Rita

**Figure 13: Results of GAO Review of Quality Reinspections of Hurricanes Katrina and Rita Claims Processed Using Expedited Procedures**



Source: GAO.

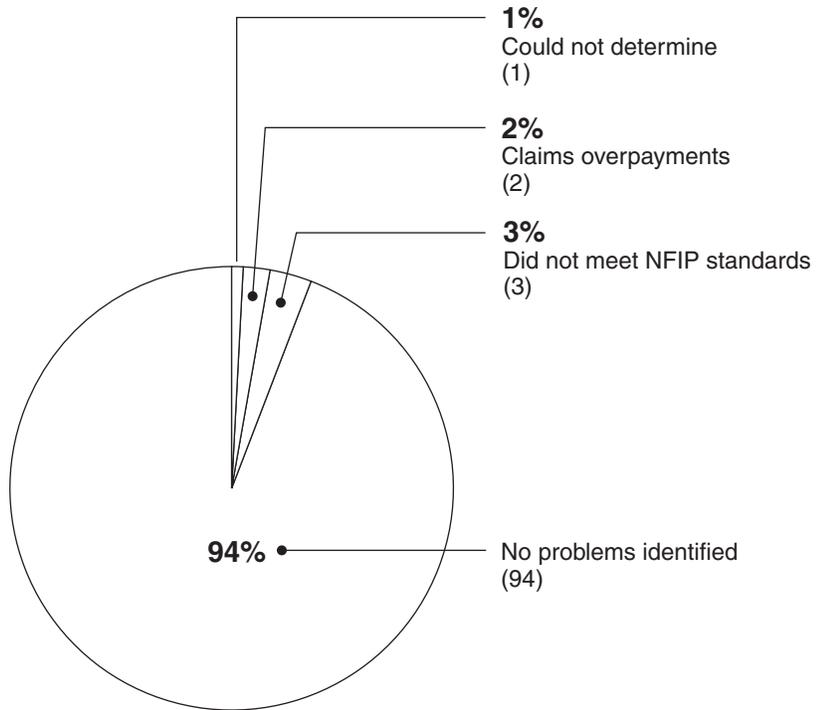
Figure 14: Results of GAO Review of Quality Reinspections of Hurricane Katrina Claims Processed Using Regular Claims Adjustment Procedures



Source: GAO.

Note: In instances in which reinspectors did not complete reinspection reports. We were unable to determine whether they identified problems.

**Figure 15: Results of GAO Review of Quality Reinspections of Hurricane Rita  
Claims Processed Using Regular Claims Adjustment Procedures**



Source: GAO.

Note: In instances in which reinspectors did not complete reinspection reports. We were unable to determine whether they identified problems.

# Appendix V: State Actions on Training of Agents That Sell NFIP Policies

## States That Have Taken Action Regarding Training of Agents that Sell NFIP Policies (as of October 2006)

State	Action taken
Delaware	Department of Insurance required agents authorized to write homeowners or personal lines of insurance to complete a 2-hour continuing education course on flood insurance and the NFIP.
Iowa	Commissioner of Insurance required agents who sell flood insurance to comply with the minimum training and education requirements and demonstrate that compliance upon request of the Commissioner.
Kansas	Commissioner of Insurance required agents who sell flood insurance to complete a onetime, 3-hour course related to the NFIP, beginning with license renewals on January 1, 2007.
Kentucky	Office of Insurance issued advisory opinion stating requirement that agents selling NFIP policies complete a onetime, 3-hour course related to the NFIP.
Louisiana	Legislature required a onetime, 3-hour course on flood insurance to be completed by agents authorized to write property and casualty lines of insurance for initial licensure and/or license renewal.
Maine	Superintendent of Insurance directed licensed insurance agents who sell NFIP policies to comply with the minimum training and education requirements and demonstrate that compliance upon request of the bureau.
Maryland	Department of Insurance required property casualty insurance producers who sell flood insurance to complete at least two of their required continuing education credits in flood insurance by September 30, 2006, regardless of when their licenses renew, and each renewal period thereafter.
Massachusetts	Commissioner of Insurance required agents licensed after April 4, 1983, who sell flood insurance to complete 3 hours of continuing education on flood insurance by December 31, 2006.
Missouri	Department of Insurance required agents who sell flood insurance to complete at least 3 hours of NFIP-related training by December 31, 2009.
Nebraska	Department of Insurance required agents who sell flood insurance to complete a onetime, 3-hour course on flood insurance beginning with license renewals on January 1, 2007.
Nevada	Commissioner of Insurance directed licensed insurance agents who sell NFIP policies to complete a onetime, 3-hour course on flood insurance.
North Carolina	Commissioner of Insurance sent letters to insurance agents who met their 2005 continuing education requirements that encouraged them to take a continuing education course on flood insurance.
Pennsylvania	Insurance Department issued a notice advising insurance companies and agents of the training and education requirements and encouraging agents to attend NFIP flood insurance program workshops.
Rhode Island	Department of Business Regulation directed licensed insurance agents who sell NFIP policies to comply with the minimum training and education requirements and demonstrate that compliance upon request of the department.
South Dakota	Director of the Division of Insurance directed licensed insurance agents who sell NFIP policies to comply with the minimum training and education requirements and demonstrate that compliance upon request of the division.
Texas	Department of Insurance adopted new sections of its Insurance Code establishing standards for a department-certified continuing education course on the NFIP and flood insurance.
Utah	Commissioner of Insurance directed licensed insurance agents who sell NFIP policies to comply with the minimum training and education requirements and demonstrate that compliance upon request of the department.
Washington	Commissioner of Insurance directed agents who sell flood insurance policies to complete a onetime, 3-hour course on flood insurance.

Source: FEMA.

# Appendix VI: Comments from the Department of Homeland Security

U.S. Department of Homeland Security  
Washington, DC 20528



**Homeland  
Security**

December 8, 2006

Mr. William O. Jenkins, Jr  
Director  
Homeland Security and Justice  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Jenkins:

Thank you for the opportunity to review and comment on the Government Accountability Office's (GAO's) draft report GAO-07-169 entitled *NATIONAL FLOOD INSURANCE PROGRAM: New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved*.

The Federal Emergency Management Agency's (FEMA's) comments are reflected in the following four areas:

**Results of Monitoring and Oversight of Claims Payments Were Inconclusive because FEMA Did Not Reinspect a Statistically Valid Sample of Claims**

**Comment:** To address the issues discussed relating to monitoring and oversight of claims payments, the Write Your Own (WYO) Financial Control Plan, Part 3, which addresses the claims reinspection program is being revised to fully reflect GAO's recommendations and will be adhered to in future flooding events.

**General Adjusters and Disaster Analysts Did Quality Reinspections of About 2.5 Percent of All Claims and Additional Reinspections of Claims Adjusted Using Expedited Processes**

**Comment:** FEMA does not have a percentage goal of reinspections to be completed. As outlined in the WYO Financial Control Plan, Part 3, the reinspection program uses a binomial table and based upon the acceptable three percent error rate, the General Adjuster reinspects the corresponding number of claims. If, based on the General Adjuster's findings, a company's error rate exceeds three percent, the General Adjuster will reinspect additional claims that amount to the difference between the three percent sample size and the company's actual error rate sample size. In addition to these reinspections, FEMA decided to review an additional ten percent of the expedited claims which were completed by the insurance companies that participated in the expedited claims process.

[www.dhs.gov](http://www.dhs.gov)

**Quality Reinspection Program Does Not Rely on a Statistically Valid Sampling Methodology**

**Comment:** FEMA did not have the opportunity to adopt GAO's October 2005 recommendation that FEMA select the claims to be reinspected in its quality reinspection program by using a random sample of the population of all claims. Hurricane Katrina hit on August 29, 2005, before GAO's recommendation was made, and Hurricane Rita occurred shortly after Katrina. Due to the magnitude and timing of these storms, other priorities took precedence to meet the needs of claimants and communities. FEMA intends to adopt GAO's recommendation in future flooding events.

It is difficult to understand how GAO reached a conclusion that FEMA is not meeting an internal control standard without giving a thorough consideration of all the controls and processes that FEMA has in place to provide oversight of the Program.

**Some States Have Established Minimum Education and Training Requirements**

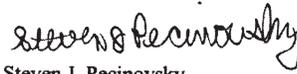
**Comment:** In Section 207 of the Flood Insurance Reform Act of 2004 (FIRA 2004), Congress directed FEMA to work within the existing regulatory framework in implementing agent training requirements. The FIRA 2004 did not establish milestones, deadlines, funding, consequences, or incentives for State actions related to flood insurance training. Therefore, FEMA's approach has been to set performance measures for itself, designed to meet the Congressional objective. These performance measures, as cited in the GAO report, include providing technical assistance to the State Insurance Departments to encourage and assist them in mandating flood insurance training for insurance agents. The performance measures are critical action items and FEMA managers and staff are held accountable. These measures are reflected in the performance "scorecards" of the Mitigation Division's Risk Insurance Branch, and Industry and Public Relations Section. Further, they are also reflected in the individual employee performance plans of the managers of those two organizational components.

Two major steps forward include:

- The National Association of Insurance Commissioners (NAIC's) adoption on September 10, 2006 of a model flood insurance training bulletin, along with the NAIC's action plan to promote and foster state implementation. Numerous States, beyond the 14 cited in the GAO report, are using the NAIC model to issue their flood insurance training requirements for agents.
- Virginia and Kansas of the National Flood Insurance Program (NFIP) have approved online training courses. This online training allows the agents who complete the course to earn continuing education credits. The online training course has also been sent to all 50 States, and the NAIC reciprocity agreement is expected to ease their review and approval process.

Thank you again for the opportunity to comment on this draft report and we look forward to working with you on future homeland security issues.

Sincerely,



Steven J. Pecinovsky  
Director  
Departmental GAO/OIG Liaison Office

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# Appendix VII: GAO Contact and Staff Acknowledgments

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## GAO Contact

William O. Jenkins, Jr. (202) 512-8777 or [jenkinswo@goa.gov](mailto:jenkinswo@goa.gov)

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## Acknowledgments

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