



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-114860

May 31, 1978

The Honorable Thomas F. Eagleton
United States Senate

Dear Senator Eagleton:

Your November 22, 1977, letter asked that we review certain aspects of the Department of Housing and Urban Development's (HUD's) determination to convert from an industry operation (Part A) of the National Flood Insurance Program to a Government-operated (Part B) program. In accordance with your request, our examination considered whether

- the Program had reached a "last resort" status where it could no longer be carried out under Part A and would be "assisted materially" by the Government's assumption of operational responsibility,
- HUD's \$15-million estimate of the cost savings relative to the assumption was supportable,
- the administrative and financial controls implemented by the Part B contractor are effective,
- the Federal Insurance Administration (FIA) has the ability to effectively monitor the Part B contractor, and
- centralized policy servicing and claims review will affect the level of services to policyholders.

You also asked us to review certain legal questions concerning a November 4, 1977, contract between HUD and the Part B contractor, E.D.S. Federal Corporation (EDS). A separate March 15, 1978, letter provided our opinion on the legal questions raised. In particular, our letter

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commented on the legality of the conversion. A Part B program is not limited by a requirement that the Part A industry-operated program reach a last resort. Rather, the act expressly empowers the Secretary of HUD to convert to Part B should she determine that such a conversion would assist materially the program's operation. In this letter we comment further on the last resort issue.

BACKGROUND

The National Flood Insurance Program was established under authority of the National Flood Insurance Act of 1968 (42 U.S.C. 4001 et seq.). It is a subsidized, Government-sponsored program designed to help owners of real or personal property purchase flood insurance. FIA administers the program.

The 1968 act authorized the Secretary of HUD to operate the program as either

--an industry program with Federal financial assistance (Part A) or

--a Government program with industry assistance (Part B).

The act provided that the Secretary implement Part A initially. It encouraged insurance companies to form a pool to provide the flood insurance coverage authorized by law. HUD, however, is allowed to convert the program to Part B if the Secretary determines it could not be carried out under Part A or its operation would be assisted materially by a Federal Government assumption.

On June 6, 1969, HUD entered into an agreement with the National Flood Insurers Association (NFIA), a pool of insurance companies, to provide the authorized insurance coverage on a limited-risk-sharing basis. Membership in NFIA was open to all companies licensed under the laws of any State to write property insurance. In addition to the sale of insurance, NFIA was responsible for much of the administrative and accounting functions related to the Program.

Over the years, however, numerous problems developed between NFIA and HUD which eventually resulted in a renegotiation of the 1969 agreement. Among the more important issues, as noted by the Secretary in her November 2, 1977, decision to convert to Part B, were (1) HUD wanted the right to review and approve NFIA's overhead operating budget, but NFIA refused to accede to that point, (2) NFIA refused to

competitively bid its servicing contracts, and (3) HUD and NFIA disagreed on the extent of Secretarial authority over the program regarding policy decisions and regulatory authority. In February 1976 Arthur Andersen & Company had added to these problems by issuing a report disclosing serious weaknesses in NFIA's automated accounting system.

While the 1969 HUD/NFIA agreement was self renewing, either party could request that negotiations of its terms be reopened. In September 1976 HUD decided that such negotiations could best resolve their disagreements.

In July 1977 NFIA stated that it did not intend to renew the Part A agreement which was to terminate on December 31, 1977. NFIA expressed a desire, however, to continue its involvement in the program but only under a new agreement. Although Part A negotiations continued, HUD issued a July 21, 1977, request for proposals to operate the program under either a Part A or Part B arrangement. According to the Secretary, this measure was taken to ensure continuity of program operation should NFIA and HUD not agree on new terms. On September 23, 1977, HUD received two Part B proposals. After reviewing the two contractors' offers, HUD decided to negotiate with EDS to refine its cost and technical proposals.

At about the same time, NFIA submitted a proposed Part A agreement and reiterated its desire to continue program operation. On October 4, 1977, HUD received NFIA's proposed budget for central headquarters functions. After discussions with NFIA, HUD estimated certain other costs of doing business under Part A that were necessary for comparison to Part B and obtained NFIA's general confirmation of these estimates.

At that point HUD was able to compare NFIA and EDS total costs for program operation. It found about a \$15 million cost difference. Largely on the basis of this difference, the Secretary decided on November 2, 1977, that Government operation would assist materially the National Flood Insurance Program. The Part B takeover was effective January 1, 1978, when the HUD/NFIA agreement terminated.

DID THE FLOOD INSURANCE PROGRAM REACH A
LAST RESORT STATUS UNDER PART A ?

At the time the Secretary of HUD made the decision to go to Part B, the program had clearly not reached a last resort status under Part A. A few weeks before the November 2, 1977,

decision by the Secretary to convert to Part B, tentative agreement was reached by HUD and NFIA officials on the major points of disagreement.

HUD and NFIA had renewed efforts to devise a new Part A agreement in late July 1977 after HUD issued the request for proposals. Negotiations with NFIA over new contract provisions had been going on since September 1976 but were temporarily stopped on three occasions.

On September 8, 1977, HUD's General Counsel testified before the House Subcommittee on Housing and Community Development that the last and overriding issue on which negotiations foundered was HUD's right to review NFIA's operating expense budget. She stated that had HUD and NFIA been able to reach agreement on that issue, they would have had a contract. However, she believed that the failure to resolve the issue called into question whether HUD and NFIA truly had resolved another issue concerning Secretarial authority. NFIA conceded the budgetary issue. By October 19, 1977, NFIA and HUD had drafted a new Part A agreement, providing for

- HUD's right to prior approval of the NFIA operating budget,
- some degree of competitive bidding for servicing company contracts,
- HUD's role in policy interpretation, and
- renegotiation of the Government/industry risk sharing formula.

Clearly, the potential existed for NFIA and HUD to have entered into a new Part A agreement at that point.

The Secretary, however, decided to use her statutory authority to convert to Part B on the premise that the flood insurance program would be assisted materially by Federal Government assumption. She reached this decision after FIA's cost comparison revealed that HUD could manage the program directly in 1978 under contract with EDS for almost \$15 million less than under the NFIA agreement.

In advising the Secretary on the choice between Part A and Part B, FIA stated that had all things been equal, the Government would have continued the relationship with NFIA,

since their prior budgetary control dispute had been satisfactorily resolved. However, the Government did not believe that all things were equal because the \$15-million savings would materially assist the program.

In support of her decision, the Secretary cited as pertinent findings in her November 2, 1977, report to the Congress that (1) HUD was not satisfied that NFIA had corrected control weaknesses identified by us in a March 21, 1977, letter (CED-77-47) to her, (2) NFIA, during its Part A tenure, had refused to accept the Secretary's interpretations of the flood insurance policies or competitively bid its servicing contracts, (3) there seemed to be no Part A advantage that would outweigh the lower costs of Part B, and (4) the amount by which the cost under Part A would exceed the cost under Part B would grow.

WAS HUD'S ESTIMATE OF A \$15-MILLION
COST SAVINGS SUPPORTABLE ?

As previously stated, the Secretary's decision to convert to Part B was based largely on the \$15-million cost savings. We found that:

- Although some revisions to both NFIA and EDS cost projections were necessary to adequately make a comparison, the \$15-million differential was supportable; however, many intangibles exist that are not subject to comparison.
- NFIA and HUD had agreed on some potential cost-savings techniques which could have affected future costs.
- HUD considered but did not resolve the propriety of payment of premium taxes under Part A before the takeover.
- HUD intends to reduce premiums to policyholders on the basis of projected savings.

Cost proposals support the
\$15-million differential

Our comparison of the NFIA budgeted costs and EDS's cost proposal showed that the \$15-million estimated savings is supportable. We found that after the November 2, 1977, report to the Congress, both NFIA and EDS cost estimates were revised slightly, reducing the estimated savings. Also, some EDS and

NFIA costs were not comparable, and the periods covered by the proposals with regard to operating the program were dissimilar. After making adjustments in the estimates of cost savings for these variances, however, we found that the savings still approximated \$15 million. Our revision of HUD's estimated cost savings is shown on Enclosure I. Specific comments on these points follow.

Revisions made by FIA to cost estimates

Subsequent to the Secretary's November 1977 report to the Congress, FIA increased EDS's proposed costs and identified a significant error in NFIA's cost estimates. This reduced the potential savings by \$593,000.

In developing its initial cost comparison, FIA used EDS's cost proposal submitted in response to HUD's request for proposals. FIA added transition and some printing costs for comparison purposes. When HUD subsequently signed a contract with EDS, these costs were increased by about \$1.9 million because of revised requirements. Salaries, data processing, and EDS's fixed fee were increased because HUD and EDS agreed on a first-year, increased level of effort. Revised program requirements caused map distribution costs to increase. EDS's corporate allocation cost was increased because it was a function of the total cost.

On the NFIA side, FIA used the fiscal year 1978 operating budget, supplemented with estimates of certain additional costs, for comparison purposes. FIA subsequently identified an error in its computation of NFIA servicing company fees, raising the NFIA costs by about \$1.3 million.

Incomparable levels of activity

Part of the cost difference between EDS and NFIA proposed costs existed also because some items were not based on comparable levels of activity. Our readjustment of those costs to a comparable basis showed an increase in potential savings of about \$667,000, including increased NFIA map distribution costs of about \$488,000 and postage and claims adjustment costs of about \$179,000.

With regard to ADP work, HUD and EDS had not yet decided on how systems development would be done. For contract purposes they agreed to show 6,900 staff days of effort over a 16-month period with about 3,900 days for the first contract year. NFIA's development costs for 7,500 staff days in fiscal year 1978 was based on a work plan developed in 1977.

Because the nature and extent of EDS systems development effort had not yet been established, it was not practical to compare it to NFIA's effort. However, if EDS used 7,500 staff days, EDS's contract costs would be as much as \$300,000 higher. This difference was, however, not included in our reconciliation of cost differences between the two cost proposals.

The cost of established flood disaster centers is reimbursed separately by HUD. These costs, however, should be higher under Part B because EDS does not have available decentralized facilities as did NFIA. We were informed that these costs, for the first 4 months of 1978, totaled about \$17,000.

Dissimilar contract periods

Further, NFIA's budgeted figures reflected a continuation of normal operations for 12 months from October 1, 1977, through September 30, 1978. The EDS contract also covered 12 months from November 4, 1977, through November 3, 1978; however, during the last 2 months of 1977, EDS was preparing to implement full operation.

To better compare these proposals, we subtracted from EDS's cost proposal start up costs and transition costs of \$2.2 million, leaving 10 months of full operating costs. We projected that figure for 1 year, and the result was an increase of about \$2.0 million to the EDS proposal for comparative purposes. These changes have the effect of increasing the cost differential by about \$238,000.

Other issues affecting cost and program efficiency

Numerous other issues that also relate to the two methods of operating the flood insurance program could have a bearing on either the relative cost or efficiency of the program. These issues were discussed by NFIA in its November 18, 1977, response to HUD's Part B report and by the study of the cost proposals by the Actuarial Research Corporation. A listing of the issues is included as Enclosure II. Although these issues are important and could relate to the success of Part B as compared to Part A, the extent of their effect is certainly argumentative before the fact and, in many cases, may be argumentative after the program has operated under Part B for a period of time. Therefore, at this point it is impractical to try to evaluate these issues in relation to the Part B takeover.

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While, on the basis of analysis of the cost proposals, the \$15-million cost savings estimate is supportable, the true test of whether the switch to Part B was financially sound will be determined later. At the end of the first year, EDS's actual costs could be compared to its proposed costs, and services rendered by EDS could be evaluated. On the basis of these examinations, the relative success of Part B could be assessed. We neither reviewed EDS's actual costs to date nor evaluated such costs in relation to the cost proposal because only a few months have transpired since the EDS takeover.

Cost reductions may have been possible under Part A

In her justification to convert to Part B, the Secretary identified issues related to (1) centralized versus decentralized policy and claims review and (2) NFIA allowance versus the EDS fixed fee as two of the three major cost differences between EDS and NFIA. Because of proposed contract changes negotiated between NFIA and HUD before the takeover, some cost reduction in these areas may have been realized in future years had operation of the program continued under Part A.

While NFIA agrees that the program could be operated in a centralized manner at less cost, it was fully committed to the concept that insurance organizations provide better service to policyholders, agents, and adjusters with decentralized operations. The higher costs resulting from fixed fee payments to servicing companies by NFIA, in relation to lower centralized administration costs of EDS, represent the cost effect of operating the program in a decentralized rather than a centralized manner. NFIA realized that these fees were probably too high and intended to reduce them. During the HUD/NFIA negotiations, NFIA agreed to begin in 1978 to competitively bid the larger servicing company contracts, which, according to sound procurement policies, should produce a better price. NFIA also believed that it could gain more efficiency by consolidating some of its 46 servicing company locations. Because NFIA is no longer operating the flood insurance program, however, any future impact of these changes is not practical to determine.

The NFIA allowance of about \$5.4 million represented, in effect, the program cost for the insurance industry's risk sharing under Part A. Each year NFIA was paid up to

5 percent of policyholders' premiums out of the program's net income. Any income over the 5 percent went into a reserve to cover future losses or to pay the allowance to NFIA in a year when net income was insufficient to cover the 5 percent allowance. In a year where program losses were so great as to absorb the 5 percent and the cumulative reserve fund, NFIA member companies would have had to share in the losses out of their pledged risk capital. During the 8 year history of the program, however, profits had been sufficient to pay the allowance in full, as well as to develop a \$43-million reserve fund balance at June 30, 1977, the date of the last financial audit. EDS's fixed fee was about \$1.1 million but represented no risk to EDS arising out of insurance losses.

In 1977, as a result of their negotiations, HUD and NFIA tentatively agreed on a new formula for sharing losses. The new formula would have increased the member companies' risk in any given year where large-scale flooding occurred, but both HUD and NFIA officials agreed that the long-term profit expectation remained about the same. Because future risk to NFIA would be affected by flood losses and related expenses that are largely contingent on natural conditions, the cost impact to the program is not readily predictable.

The propriety of paying State premium taxes under Part A was under consideration

The Secretary identified the payment of State premium taxes as the third major cost difference. In mid-1975 NFIA questioned the propriety of paying these taxes under the flood insurance program. State premium taxes make up about \$3.5 million of the estimated \$15-million savings. HUD considered but never fully resolved the problem. Instead it became 1 of 33 issues in the negotiation between HUD and NFIA for the proposed new contract. No decision was made by HUD on the tax problem before the takeover.

In August 1975 NFIA became aware of increasing legislative activity by municipal and county governments in the area of property insurance premium taxes and suggested that the authority of State and local government to assess various taxes on flood insurance premiums be looked into. NFIA asked that HUD's Office of General Counsel determine the legal ground for an exemption from these taxes.

The question was considered by a HUD Assistant General Counsel, who in December 1975 provided a draft opinion to the Acting Administrator, FIA, that one type of tax was valid and

another type was questionable. Further, on the basis of a question concerning premium taxes from an NFIA steering committee, the tax counsel of one of the large member insurance companies concluded that NFIA had three possible grounds for supporting a position of no liability for State premium taxes. NFIA officials informed us that they may have been receptive to not paying the tax if HUD would have issued a directive that the flood insurance program was a Federal program and, therefore, Federal statutes would preempt State statutes on the payment of taxes.

FIA officials told us that while the issue of State taxes was important, it was subordinate to other issues and did not receive a high priority for resolution. As of September 1976 it became 1 of 33 issues subject to negotiation with NFIA when it was decided to try to devise a new operating contract.

In August 1977 HUD's Office of General Counsel, in response to a question from the Deputy Federal Insurance Administrator, made the decision that if the Federal Government operates the National Flood Insurance Program as the sole insurer, without any assumption of risk by the private insurance industry, then the Federal Government is constitutionally immune from taxation on premiums it receives pursuant to the program. Therefore, premiums now collected under Part B are not subject to the premium tax.

Premiums to some policyholders could be reduced based on the projected cost savings

HUD is considering reducing premium rates to some policyholders on the basis of the projected savings under Part B operations. It has proposed that premiums to policyholders whose rates are determined on an actuarial basis could be reduced by about \$10 for the average premium paid. Only about 8 percent of premiums are based on actuarial rates. Most premiums are currently based on subsidized rates--a temporary rate used for policyholders in communities which have not yet had sufficient planning and mapping studies completed to be put into a regular flood insurance program.

The actuarial rates include a \$15-expense constant. Under Part B operations of the program, the portion of the rate applicable to State premium taxes and the underwriting profit could be eliminated. Also, the portion of the rate applicable to servicing fees paid and the NFIA home office expense could be replaced by the lower EDS cost of operation plus its fixed fee.

FIA officials told us that the rate reductions could be put into effect by August 1978 and could affect about 100,000 policyholders. The savings to them could amount to about \$1 million.

ARE GOVERNMENT ADMINISTRATIVE AND FINANCIAL CONTROLS OVER EDS ADEQUATE ?

You asked that we review the status of administrative and financial control weaknesses as disclosed by our March 1977 letter to the Secretary of HUD and by HUD's Inspector General or if the program is converted to a Part B program, you requested that we review the system controls of the Part B contractor.

HUD's Acting Inspector General has scheduled a survey of EDS to start during May 1978. One of the objectives of the survey will be to examine the controls of EDS related to preparation of financial statements and other financial data needed by FIA to manage the flood insurance program and identify problem areas. Further, HUD told us that it also intends to hire a public accounting firm to review EDS's financial and ADP controls.

We intend to review conclusions of both the Inspector General and the public accounting firm selected for examination of EDS's system. Also, we are required to perform an examination of the financial statements of the flood insurance program under requirements of the Government Corporation Control Act. The timing of a future review will depend on whether the aforementioned reviews of the Inspector General and the selected public accounting firm show any significant weaknesses in EDS's control system. Therefore, at this time we will not duplicate their efforts but will monitor the progress and results of their work.

DOES FIA HAVE THE ABILITY TO EFFECTIVELY MONITOR EDS ?

FIA's procedure for monitoring under the EDS contract should be effective. The Government has set up procedures to obtain timely information on EDS's performance intended to assure that program objectives are being met.

During 1977 HUD's Office of Inspector General reviewed FIA's monitoring of the NFIA-operated program. It reported that no organizational element within FIA was primarily responsible for the monitoring and technical guidance of NFIA, causing such efforts to be uncoordinated and ineffective.

Further, the Office of Inspector General said that FIA and NFIA could have prevented the program computer system problems had they exercised stronger roles in its development and implementation by the subcontractor.

We believe that FIA's monitoring procedures could correct the deficiencies reported by the Office of Inspector General. The contract provides for

- a Government Technical Representative with primary responsibility to monitor, inspect, and evaluate EDS's technical performance;
- six Government Technical Monitors to monitor specific functional areas; and
- regularly scheduled progress meetings and written reports.

While observing operations and advising EDS in its respective functional areas, the Monitors are expected to assess EDS's performance. They can compare actual progress to that agreed on in the contract and in a management plan submitted by EDS. FIA developed a program evaluation review technique to monitor critical activities as well as overall performance. Performance information is reported to the Government Technical Representative who in turn is responsible for reporting weekly to HUD's Under Secretary.

The contract also provides for HUD to exercise direct control over EDS's development and implementation of the computer system. Further, EDS may not subcontract any data processing work except selected mechanical functions, such as keypunching, and HUD has the right to inspect and evaluate such work. We believe this system is a substantial improvement over FIA's monitoring of NFIA. It appears to be adequate for the Government to effectively monitor the operation.

Additional Government monitoring costs

The Government cost of monitoring the program was not included in the FIA comparison of NFIA and EDS costs. We found that this cost is higher under Part B but that it should result in increased effectiveness.

Five of six Monitors under Part B previously acted as liaisons with NFIA; however, some members of that staff have provided increased time to monitoring EDS. The sixth

Monitor was assigned from HUD's Office of ADP Operations to review EDS's computer system. Also FIA intends to hire someone to fill the position of Government Technical Representative. The Deputy Administrator currently holds that position in addition to his normal duties. We believe that while these actions do represent increased governmental costs, additional benefits could accrue to the program through a more effectively supervised procedure.

WILL CENTRALIZED POLICY SERVICING
AND CLAIMS REVIEW AFFECT THE LEVEL
OF SERVICES TO POLICYHOLDERS ?

HUD expects to operate the flood insurance program under Part B through centralized operations. NFIA also could have centralized under Part A, but felt that its decentralized system provided better service to policyholders, insurance agents, and adjusters.

We reviewed Part A operations and Part B proposed operating procedures and found the type of service to policyholders to be similar. We also reviewed the effect of the change on insurance agents, as the Government's relationship with the agents has a bearing on services to policyholders. Although the Government intends to provide the same services as NFIA, some agents were concerned about the federally operated program. FIA believes this attitude has already improved and will continue to improve over time.

Services to policyholders

Under both operations property owners complete applications for insurance with their insurance agents. NFIA had the agents forward these applications to 1 of 46 local servicing companies, while EDS is having them sent to its Bethesda, Maryland, headquarters. In either case, coverage is effective 15 days after the application date. Policyholders will continue to receive computerized billings for renewal insurance premiums, with the payment going to EDS headquarters rather than NFIA.

When flooding occurs, policyholders report the damage to their local agent. The NFIA servicing companies assigned a local insurance adjuster to the case. EDS plans to assign local adjusters from its headquarters. Once the adjuster submits his report, a claims examiner reviews the case and determines the amount to be paid. NFIA used the servicing

companies to examine claims, and then reviewed settlement of larger claims centrally, before payment. EDS will settle claims and approve payments centrally.

When widespread flooding occurs, extra effort is needed to meet policyholders' needs. NFIA usually used the local servicing company to handle a disaster situation, with other servicing companies or temporary staff assisting when necessary. In only three instances did NFIA need to set up separate disaster centers.

EDS's regional managers will recommend when a disaster center is needed. If approved, EDS headquarters will send a team of claims examiners. Adjusters will be assigned from the disaster center. If needed, EDS will use temporary staff to keep processing current. In addition, FIA has told us that it plans to make more partial payments to policyholders where flood damage is unquestionable.

Service to agents

EDS plans to provide essentially similar services as NFIA to insurance agents. Flood map distribution should remain the same because EDS plans to use the same two contractors that NFIA used to handle most of this function. EDS plans to continue the educational workshops for agents that NFIA developed. Promotional activities, including lenders' seminars and information distribution, will also be continued.

Representatives of two major insurance agents associations indicated to us that some agents are concerned about the Government's ability to operate the program and would generally prefer working with the insurance industry. The association officials indicated that they are cooperating with EDS to change the agents' attitudes.

To improve this attitude, EDS plans are to hold several workshops in the near future, participate in some insurance industry seminars, and keep in contact with industry associations. EDS and FIA feel confident that the Part B program will gain more acceptance by the agents as they improve its operations and continue promotional efforts.

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The matters covered in this report were discussed with FIA, NFIA, and EDS officials, and their comments have been incorporated where appropriate. We plan to make copies of this report available to interested parties upon request, beginning 3 days after the report date.

Sincerely yours,

A handwritten signature in cursive script that reads "Henry Eschwege".

Henry Eschwege
Director

Enclosures - 2

GAO'S REVISED ESTIMATE OF COST SAVINGSNFIA AND EDS COST PROPOSALS

(thousands)

Estimated cost savings cited by HUD in 11/2/77 report to the Congress		\$14,770
Add:		
Increased NFIA costs due to FIA error in computing servicing company fees	\$1,269	
Incomparable costs	667	
Elimination of transition and start-up costs--EDS	<u>2,211</u>	<u>4,147</u>
Subtotal		18,917
Less:		
Increased EDS costs due to revision in cost estimate subsequent to 11/2/77 report to the Congress	1,862	
One-year projection of EDS's 10-month cost estimate	<u>1,973</u>	<u>3,835</u>
Total		<u>\$15,082</u>

COMMENTS ON CONVERSION OF FLOOD INSURANCE PROGRAMFROM PART A TO PART BFROM NFIA'S NOVEMBER 18, 1977, RESPONSE
TO HUD'S PART B REPORT

1. NFIA's responsiveness to flooding occurrences and supervision of the adjustment of claims cannot be duplicated in a centralized structure.
2. Because insurance agents, adjusters, and lending institutions do not specialize in flood insurance matters, access to a local organization has proven necessary.
3. Use of insurance entities has permitted access to reserves of trained personnel.
4. NFIA's field personnel have gained invaluable experience that will be lost.
5. The insurance industry has proven that decentralized servicing is necessary to achieve marketing success; a reduction of services may have an impact on marketing effectiveness and premium revenues.
6. Flood losses of \$260 million during fiscal year 1978 would have required the NFIA members to pay approximately \$10.5 million toward flood insurance losses.
7. Because its operating allowance was based on premiums, NFIA had a financial incentive to aggressively market and sell policies; this incentive is lost in a Part B program.
8. The Federal Government as insurer will become subject to policyholder litigation.
9. Insurance agents and adjusters who participate in the program will become direct agents of the Federal Government, which will become liable for the acts of its agents.
10. State Insurance Department regulation, supervision, and policyholder assistance services will be eliminated and the burden shifted to the Government.
11. NFIA member companies provided, at no cost to the program, insurance expertise; HUD will be without these valuable resources unless they are retained at Government expense.

12. Both NFIA member and servicing companies provide, at no extra cost to the program, promotional and agent training support beyond that required by the contract.

FROM NOVEMBER 1977 ACTUARIAL RESEARCH
CORPORATION "ASSESSMENT OF COST
ESTIMATES FOR ADMINISTERING THE
NATIONAL FLOOD INSURANCE PROGRAM"

1. Although under neither option can the level of Federal costs be determined in advance, NFIA costs are more likely to prove to be reasonable estimates because they are projections of actual prior year expenses; EDS costs are not.
2. The costs enumerated in the EDS proposal can by themselves be given only limited credibility because of the uncertainties provided by a cost-plus contract.
3. Because the EDS contract is on a cost-plus, fixed-fee basis with additional costs paid by the Government, the contractor may have had an incentive to underbid.
4. The assumptions that the automated systems under development by NFIA will be completed and will perform efficiently and effectively with the resources enumerated are not supported by evidence.
5. Because a breakdown of servicing company cost data is not available, it is not possible to accurately assess the relative operational cost of the two options.
6. There are intangibles involved in comparing operations by organizations with very different types of personnel and experience, concerning both competence and experience.
7. EDS has limited experience in conducting insurance operations.
8. A significant change in the level of claim payments could occur if emphasis is placed on the efficiency with which claims are paid rather than the level of claims paid.
9. The lack of experience by EDS in certain areas could require additional EDS and FIA personnel in the future; an intensified level of management presence by FIA is necessary to maintain efficient and effective program operation.