

**Murky Waters:
Increasing Transparency and Accountability
in the National Flood Insurance Program**

**Findings and Recommendations
in the Wake of Superstorm Sandy**



**From the Office of:
New York State Attorney General
Eric T. Schneiderman**

This report was prepared by the Criminal Enforcement and Financial Crimes Bureau, with special thanks to Assistant Attorneys General Robert Miller and Joseph D'Arrigo, Deputy Chief Stephanie Swenton, Bureau Chief Gary Fishman, and Executive Deputy Attorney General for the Division of Criminal Justice Kelly Donovan. Thanks also go to Assistant Attorney General Melvin L. Goldberg and Bureau Chief Jane Azia of the Consumer Frauds and Protection Bureau and Manisha M. Sheth, Executive Deputy Attorney General for the Division of Economic Justice.

Table of Contents

EXECUTIVE SUMMARY	4
THE HISTORY AND POLICY BEHIND THE NATIONAL FLOOD INSURANCE PROGRAM (NFIP).....	6
SCOPE OF COVERAGE UNDER THE NFIP	9
MARKETING OF THE NFIP	11
ADMINISTRATION OF CLAIMS FOR STRUCTURAL DAMAGE UNDER THE NFIP.....	14
FINDINGS	16
A. Lack of Clarity in the Scope of Policy Coverage	16
1. What constitutes a “flood” for purposes of the SFIP is generally misunderstood.	16
2. The type, nature, and location of flood forces play a significant role in determining coverage for structural damage.	16
3. Flood mitigation, improvements, and compliance with local ordinances and regulations are often not covered.	17
B. Inadequate Training and Lack of Certification Requirements for Structural Engineers	18
C. Poor Administration and Supervision of the NFIP Claims Process	19
1. Flow of information is inefficient.	19
2. The compensation structure for engineering services is not transparent.	20
RECOMMENDATIONS.....	22
A. Scope of Coverage and Corresponding Exclusions Should Be Transparent and Succinct, Utilizing Plain Language.	22
B. Expert Reports Prepared in Connection With Administering a Flood Claim Must Be Provided to the Policyholder in a Timely Manner.	23
C. Individuals Retained to Provide Expert Engineering Services Under the NFIP Must Be Subject to National Certification.....	23
D. Fees Charged for Expert Services Must Be Transparent.....	23
APPENDIX A	25

Executive Summary

In June 2014, counsel for owners of residential properties in New York that were damaged as a result of Superstorm Sandy reported alleged fraudulent alterations in engineering reports to the Office of the New York State Attorney General (“OAG”). Thereafter, in December 2014, the OAG commenced a criminal investigation into the suspected unlicensed practice of professional engineering and forgery of engineering reports by engineering firms operating in Nassau County and elsewhere in New York, and their owners and employees.

During the course of our investigation, we reviewed and analyzed millions of pages of materials related to both the practice of engineering generally and the flood insurance industry in particular. Our investigation included the canvassing of the National Flood Insurance Program as administered by the Federal Emergency Management Agency, the process by which policies are sold and marketed, and how claims are processed and administered in the wake of a flood event. We spoke with, and were provided feedback from, a variety of individuals and industry participants, including representatives from major insurance carriers, Federal and state officials, adjusting and engineering firms, claim administrators, and individual homeowners. Additionally, we reviewed and analyzed thousands of damage assessment reports prepared and submitted in connection with the National Flood Insurance Program’s claim administration process.

Our criminal investigation has resulted in a 50-count indictment in the New York State Supreme Court, Nassau County, of a Uniondale-based engineering firm and its former manager on charges of Forgery in the Second Degree and Unauthorized Practice of Engineering. Additionally, our investigation has uncovered evidence of other crimes which fall outside the scope of New York State’s jurisdiction. We have referred our findings to the United States Department of Justice, and we look forward to working with the appropriate federal law enforcement agencies in conjunction with this ongoing investigation.

As part of our investigation, the Attorney General has identified several fundamental flaws with the National Flood Insurance Program and its administration.¹ These flaws include:

- **A lack of clarity in the scope of coverage under the Standard Flood Insurance Policy.** Contrary to what many homeowners believe,

¹ This Report outlines the findings of our investigation related to transparency of the scope of coverage for structural damage under the National Flood Insurance Program and the process of performing structural damage causation assessments for residential properties by sub-contracted engineering firms and the corresponding administration of structural damage claims. This report does not purport to analyze claims related to policies for non-residential properties or the applicable flood coverage provisions as they pertain to contents. Furthermore, this Report is intended to convey our general findings as a result of our continued investigation, and should not be interpreted as describing how all policies were sold and marketed, and how all claims are processed and administered in each and every instance.

flood insurance coverage is complex and severely limited. What constitutes a “flood” for purposes of the standard flood policy is generally misunderstood, and policyholders are also generally unaware that the type, nature, and location of flood forces generated by the floodwaters can play a significant role in determining coverage. Contributing to this general misunderstanding are marketing materials for flood insurance, which typically fail to clearly disclose these key limitations.

- **Inadequate training and lack of certification requirements for structural engineers retained in connection with flood claims.** While adjusters retained to provide services in connection with the flood claim administration process are required to be certified, there is no such requirement for engineers or engineering firms. This lack of certification and corresponding training in structural damage causation analyses can often lead to incorrect or imprecise findings, which may in some instances cause policyholders to be either over- or underpaid on their respective claim.
- **Poor administration and supervision of the flood claims process, including the failure to provide important documentation to policyholders.** Our investigation revealed systematic inefficiencies as well as inadequate transparency and oversight in the flood claim process, resulting in delays for consumers and higher costs for taxpayers.

In an effort to address these deficiencies, and as set forth in greater detail herein, the Attorney General proposes the following reforms, each of which can be implemented with little to no incremental cost:

- Increase the transparency and clarity of the scope of flood insurance coverage and any applicable exclusions through the creation of a plain language disclosure sheet, to provide consumers with a better understanding of what is and is not covered under their flood policy.
- Provide policyholders with all documents created during the course of the flood claim administration process and ultimately relied upon in determining payment or denial of a flood claim, including all final adjuster and engineering reports, as a matter of course.
- Implement a national certification process for all engineers retained to provide structural damage assessments in the wake of a flood event.
- Ensure the transparency of fees paid to engineering experts by implementing a standardized fee schedule for all engineering services and requiring engineering experts to submit supporting paperwork with their invoices seeking payment.

The History and Policy Behind the National Flood Insurance Program (NFIP)

Prior to 1968, flood insurance generally did not exist. Flooding was (and generally remains) explicitly excluded from most homeowners' insurance policies, which typically cover damages attributable to other losses, such as wind, fire, and theft. Private insurers were generally unwilling to provide coverage within the flood insurance field for several separate yet interrelated reasons:

- The scale, scope, and timing of flood events are inherently unpredictable, rendering it exceedingly difficult to estimate potential losses;
- The economic impact of a large-scale flood could tend to render a private insurer insolvent before sufficient reserves had been accumulated to cover a major loss; and
- Private insurers have difficulty offering coverage with affordable rates.

(See GAO, *National Flood Insurance Program—Major Changes Needed If It Is To Operate Without A Federal Subsidy*, GAO/RECED-83-53 (Washington, D.C.: Jan. 3, 1983).)

Recognizing that private insurers found it unprofitable to provide adequate flood insurance, Congress enacted the National Flood Insurance Act ("NFIA") in 1968. As originally constituted, the NFIA's principal objectives were to:

- Make flood insurance coverage available on reasonable terms and conditions to property owners on a national scale;
- Identify flood-prone areas within the Nation; and
- Reduce Federal expenditures for disaster relief.

(See generally 42 U.S.C. § 4001). In order to address these objectives, the purpose of the NFIA was to provide subsidized flood insurance to property owners, issued principally through private insurers. As a result, federally-backed flood insurance was made available to residential property owners and businesses on a wide-scale and nationwide basis.

Over the years, there have been several important amendments to the NFIA. Several of these amendments were effectuated specifically to incentivize community participation in the program, including the mandate that certain property owners purchase flood insurance as a condition precedent to securing a mortgage. For example, several years following the enactment of the NFIA, Congress passed the Flood Disaster Protection Act of 1973, which made the purchase of flood insurance mandatory for owners of properties in specified flood hazard areas that were secured by mortgages

from federally regulated lenders. (See Pub. L. No. 93-234, 87 Stat. 975 (1973).)

The National Flood Insurance Reform Act of 1994—which amended both the 1968 act and the 1973 act—strengthened the mandatory purchase requirements for owners of properties located in so-called “Special Flood Hazard Areas”—areas subject to a 1% or greater chance of flooding in any given year—that have mortgages from federally regulated lenders. (See Pub L. No. 103-325, Tit. V, 108 Stat. 2160, 2255 (1994).)

Specifically, the Reform Act of 1994 requires the “Federal entities for lending regulation”² to promulgate regulations requiring the lenders they regulate to not “make, increase, extend, or renew any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified by the [NFIP] Administrator as an area having special flood hazards and in which flood insurance has been made available under the [NFIA], unless the building or mobile home and any personal property to which such financial assistance relates is covered by flood insurance.” (42 U.S.C. § 4104a.)³

The National Flood Insurance Program (“NFIP”) created by the NFIA is administered by the Federal Emergency Management Agency (“FEMA”). (See 44 C.F.R. Subchapter B.) Our investigation has revealed that the NFIP is an attempt to balance competing interests between the scope of coverage and the premium amounts required to be collected to provide that coverage. As a result, the NFIP is designed to pay both operating expenses and flood insurance claims with revenue derived from premiums received on flood insurance policies.

In reality, recent history shows that the NFIP’s liabilities greatly exceed the premiums/revenue, requiring FEMA to borrow funds from the Department of Treasury to cover incurred losses.⁴ As repeatedly recognized by the U.S. Government

² These agencies are defined to include the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Comptroller, and the Farm Credit Administration. (See 42 U.S.C. § 4003(a)(5).)

³ The NFIA has been amended several additional times since 1994. In 2004, Congress enacted the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, which authorized a pilot program to encourage owners of properties that have suffered from repeated flood loss to take certain specified steps to reduce the risk of damage. (See Pub. L. No. 108-264, Tit. I., § 102, 118 Stat. 712, 714 (2004). In 2012, Congress reauthorized the pilot program through 2017, and removed subsidized rates for a number of insured properties, such as residential properties that are not an individual’s primary residence, severe repetitive loss properties, business properties, and properties that had received payments for flood-related damage that were equal to or exceeded the property’s fair market value. (See Pub. L. No. 112-141, §§ 100203, 100205 (2012).) In March 2014, Congress enacted the Homeowner Flood Insurance Affordability Act of 2014, which sought to address affordability concerns by repealing or altering some of the legislation passed in 2012. Among other things, the 2014 legislation repealed the prohibition on the extension of subsidized rates to new property owners and allowed for the continuation of subsidized rates for those policyholders who had allowed their insurance coverage to lapse. (See Pub. L. No. 113-89, 128 Stat. 1020 (2014); see also GAO, *National Flood Insurance Program: Options for Providing Affordability Assistance*, GAO-16-190 (Washington, D.C.: Feb. 10, 2016).)

⁴ In order to maintain solvency of the NFIP, FEMA has been provided with statutory authority to borrow funds from the Treasury. (See 42 U.S.C. § 4016.)

Accountability Office (the “GAO”), the NFIP is “not actuarially sound because Congress authorized subsidized insurance rates to be made available for policies covering certain structures to encourage communities to join the program. As a result, the [NFIP] does not collect sufficient premium income to build reserves to meet the long-term” costs of future expected flood losses. (GAO, *Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program*, GAO-06-119 (Washington, D.C.: Oct. 18, 2005) (citing GAO, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, GAO-01-992T (Washington, D.C.: July 2001).) According to the GAO, “[a]s of September 30, 2015, FEMA owed [the Department of the] Treasury \$23 billion.” (GAO, *National Flood Insurance Program: Options for Providing Affordability Assistance*, GAO-16-190 (Washington, D.C.: Feb. 10, 2016).)

As part of the NFIP, FEMA created the Write-Your-Own Program, which permits private insurers (referred to herein as “WYO companies” or simply as “WYO”) to issue and administer flood policies under the NFIP. WYO companies issue coverage to private homeowners using the Standard Flood Insurance Policy (“SFIP”), and are the fiscal agents of the United States, in essence serving as administrators for NFIP. It is the federal government, not the WYO companies, which drafts the scope of coverage under the SFIP, pays claims and associated expenses, and thus bears nearly all financial risk, with the WYO company retaining a profit for administering the policy.⁵

The terms and conditions of the SFIP are codified in the Code of Federal Regulations. (See 44 C.F.R. Part 61, Appendix A(1), “Standard Flood Insurance Policy Dwelling Form.”) Pursuant to Congressional authorization, FEMA was granted broad authority to issue regulations establishing “the general terms and conditions of insurability,” including the nature and limits of loss that may be covered. Accordingly, the SFIP serves as the contractual document between FEMA and the property owner, and contains the applicable terms of coverage, including whether particular events, losses, building property and personal property are covered.

In addition to the WYO program, FEMA also offers flood insurance through the NFIP Direct program, which operates without WYO involvement. The overwhelming majority of policies, however, are administered through the WYO companies. Both programs operate within the applicable framework of NFIP regulations, rules, and interpretive guidance issued by FEMA. While either FEMA or WYO companies may issue flood insurance policies, applicable FEMA regulations expressly prohibit any change to the SFIP provisions without the express written consent of the FEMA official responsible for administering the NFIP. (See 44 C.F.R. 61.13(d) & (f).)

⁵ The WYO companies bear some risk in one area: in the wake of Hurricanes Katrina and Rita, FEMA implemented a “Collection of Overpayments” procedure that requires the WYO companies to pay out-of-pocket for any payments later determined to be in excess of what the policyholder was entitled under the SFIP.

Scope of Coverage Under the NFIP

As set forth in applicable federal statutory and regulatory schemes, the level of insurance coverage available to homeowners under the NFIP is limited in scope. By statute, there are limitations on the amount of insurance coverage homeowners may purchase for their dwellings and personal property. Specifically, Congress has statutorily set the maximum amount of insurance coverage generally available for single-family homes at \$250,000. In addition, there is also a statutory cap of \$100,000 on the amount of personal property coverage a homeowner can purchase. Accordingly, insurance payments to claimants as a result of damage sustained during the course of a flood event may be insufficient for covering all the costs associated with repairing or replacing flood-damaged property.⁶

Furthermore, and as described in greater detail herein, the applicable FEMA regulations as set forth in the SFIP further limits the scope of recovery available to property owners based on the nature and type of the loss sustained. (See 44 C.F.R. Part 61, Appendix A(1).) Indeed, as our investigation has revealed, such limitations on recovery are particularly complicated when assessing recovery for structural damage sustained by a covered property. The SFIP is a “single-peril” policy, which covers only damage caused directly to a “building” by a “flood”. By its own terms, the SFIP defines a “flood” as a “general and temporary condition of partial or complete inundation of two or more acres of normally dry land or of two or more properties...from...[an] unusual and rapid accumulation or runoff of surface waters from any source.” (44 C.F.R. Part 61, Appendix A(1), section II, Definitions.) For any resulting structural damage to a home following a storm event to be recoverable under the SFIP, there must be evidence of “direct physical loss by or from flood.” (44 C.F.R. Part 61, Appendix A(1), section I, Agreement.) NFIP defines this as “[l]oss or damage to insured property directly caused by a flood. There must be evidence of physical changes to the property.” (44 C.F.R. Part 61, Appendix A(1), section II, Definitions.) If, by contrast, the structural damage is otherwise attributable to pre-existing conditions, such as poor construction or damage due to gradual settlement of the structure, then coverage will be denied.

Also explicitly excluded from coverage is structural damage resulting from “earth movement,” such as land subsidence, “even if the earth movement is caused by flood.” (See 44 C.F.R. Part 61, Appendix A(1), section V, Exclusions.) Specifically, some examples of non-covered earth movement are (i) earthquake, (ii) landslide, (iii) land subsidence, (iv) sinkholes, (v) destabilization, or movement of land resulting from the

⁶ Flood insurance policyholders in high-risk areas (referred to as Special Flood Hazard Areas) may also be eligible to receive up to \$30,000 in additional assistance to help pay the costs to bring their home or business into compliance with certain federal, state, and/or local requirements to reduce future flood damage before they repair or rebuild. Such eligible compliance activities include elevation, flood proofing, relocation, or demotion. (See 44 C.F.R. Part 61, Appendix A(1), section III.D., Increased Cost of Compliance.) However, in no event may an insured recover an amount in excess of the statutory cap of \$250,000 for residential properties (\$500,000 in the case of commercial). As a result, a homeowner faced with the situation where they received the statutory maximum amount, but must comply with their respective community’s floodplain ordinance(s), would be personally responsible for any costs of compliance in excess of the \$250,000 amount (residential).

accumulation of water in subsurface land areas, and (vi) gradual erosion. (See 44 C.F.R. Part 61, Appendix A(1), section V, Exclusions.) Thus, coverage as it relates to structural damage under the SFIP is generally founded not on the mere inundation of water into a residential property and any corresponding damage thereto, but instead upon a showing that rapidly moving surface water or the pressure resulting from such surface water, caused the damage to the insured property.

Accordingly, our investigation has revealed that rather than a “flood” policy as that term is generally used, the SFIP as it relates to assessing recovery for structural damage would be more appropriately described as a “rapidly-moving-surface-water-causing-structural-damage-policy.” As a result, the relevant inquiry for assessing structural damage causation analyses pursuant to the SFIP is: did the damage result from: (1) rapidly moving surface water (hydrodynamic pressure), often resulting in horizontal cracking in foundation walls; (2) unequal water pressure on a structure (hydrostatic pressure), often resulting in buoyancy forces exuding upward thrusting pressure on cement flooring; or (3) high-velocity erosion of soil as a result of rapidly moving surface water (scour) that results in the undermining of the structural integrity of a building’s pillars. If the resulting damage is caused, at least in part, by one or more of these forces, then the damage may likely be covered in whole or in part. If, instead, the structural damage is otherwise attributable to pre-existing conditions, poor construction, and/or gradual earth movement (such as erosion)—even if the earth movement is caused by flood—then coverage for any structural damage will be denied.

In the aftermath of Superstorm Sandy, it was generally not in serious dispute whether subject residential properties were inundated with floodwater. Instead, and as addressed in greater detail herein, the fundamental questions of coverage as it related to potential structural damage often rested on the determination of whether (1) damage was structural in nature; (2) occurring to the “building” as that term is defined; (3) which was the result of covered “flood” forces. Any resulting conclusion by an expert retained to assess the structural soundness of a covered building could (and, in many instances, did) directly affect coverage and any corresponding recovery amount.

Marketing of the NFIP

Generally speaking, the SFIP is marketed to prospective policyholders directly through the WYO companies and their affiliated insurance agents. Like traditional insurance, flood insurance is advertised through a variety of traditional mediums, including through television, newspaper and magazine advertisements, billboards, posters, and direct mailings. In connection with their marketing efforts, the WYO companies receive what amounts to an expense allowance. (See 44 C.F.R. Part 62, Appendix A.)

As a general matter, much of the marketing materials actually utilized to sell flood insurance to homeowners are derived from templates made available by FEMA to the WYO companies and their respective agents. (See www.floodsmart.gov.) These template promotional materials are available in downloadable electronic format, allowing each WYO to customize and brand the advertisements with their own respective names, trademarks, and affiliated insurance agents' contact information. Once customized, these materials are thereafter made available to both actively solicit homeowner participation in the NFIP, as well as retain existing NFIP participants.

For its part, FEMA publishes what is, in essence, a marketing "how to" in connection with selling flood insurance. Intended for industry participants, the NFIP "Marketing Guidelines for Write Your Own Companies" instructs WYO companies on how to implement an appropriate marketing plan. (See FEMA, "Marketing Guidelines for Write Your Own Companies," available at http://www.fema.gov/media-library-data/20130726-1741-25045-2123/marketing_guidelines_2013fy.pdf.) Specifically, the Guidelines provided by FEMA emphasize the WYO companies' role in persuading homeowners of the need for flood insurance; yet, the Guidelines themselves are virtually silent as to how to educate homeowners on coverage limitations and exclusions.

Based upon our investigation to date, NFIP marketing materials generally provide basic coverage information, often excluding details relating to what is not covered under the policy. As a result, NFIP marketing is geared almost exclusively towards informing the general public why they need flood insurance, yet is virtually silent as to what is covered and, perhaps more importantly, what is explicitly excluded. For example, the following flood insurance promotional material is excerpted from the websites of several prominent WYO companies:



Flood Insurance Service And Claims

It's easy to manage your policy, report a claim, or just chat about your flood insurance policy. Call us at [\(855\) 716-2302](tel:8557162302) to talk or to report a claim please refer to [our list of partners](#)

Prepared for that rainy day.

Flood policies must be paid in full. Typically payment can be rolled into your mortgage, or paid by credit card.



When it rains it pours.

It's what's inside that counts but the outside matters too when it comes to your house. Help protect both with flood insurance.

(See <https://www.geico.com/flood-insurance/>.)

What does Flood Insurance cover?

Flood insurance is an optional insurance coverage that can help protect your home against the damage caused by flooding. And you don't have to live along the coast or near a river to need it. Even areas considered at lower risk can be vulnerable to flooding because there are so many conditions that can cause it, including poor drainage systems, rapid accumulation of rainfall, snowmelt, and construction run-off.

Shopping for a flood insurance quote? You'll need flood insurance to protect your home if:

- You live in a colder climate where the ground freezes and snow accumulates. The ground closest to your house thaws first. When this happens, melted snow can saturate the unfrozen ground next to your house and then spill into your basement. You need flood insurance.²
- Wildfires scorch the land around your home and destroy all vegetation. The following year, during a rainy season, the lack of vegetation leads to flash floods and mudflows that ruin your part of your home. You'll need flood insurance.²
- The area you're living in experiences long cold spells that cause rivers to freeze. If the water level rises, or a thaw breaks the ice into big chunks, those chunks of ice could end up creating a dam which results in flooding. If you live in the nearby area, you'll need flood insurance to cover the damage your home may incur.³

(See <https://www.thehartford.com/aarp/homeowners-insurance/flood-insurance/>.)

In addition to WYO companies' promotional materials, FEMA, through NFIP direct (non-WYO-participating), also prepares and disseminates materials, such as the following:



(See <https://agents.floodsmart.gov/Agents/downloads/Misconceptions%20DM.pdf>.)

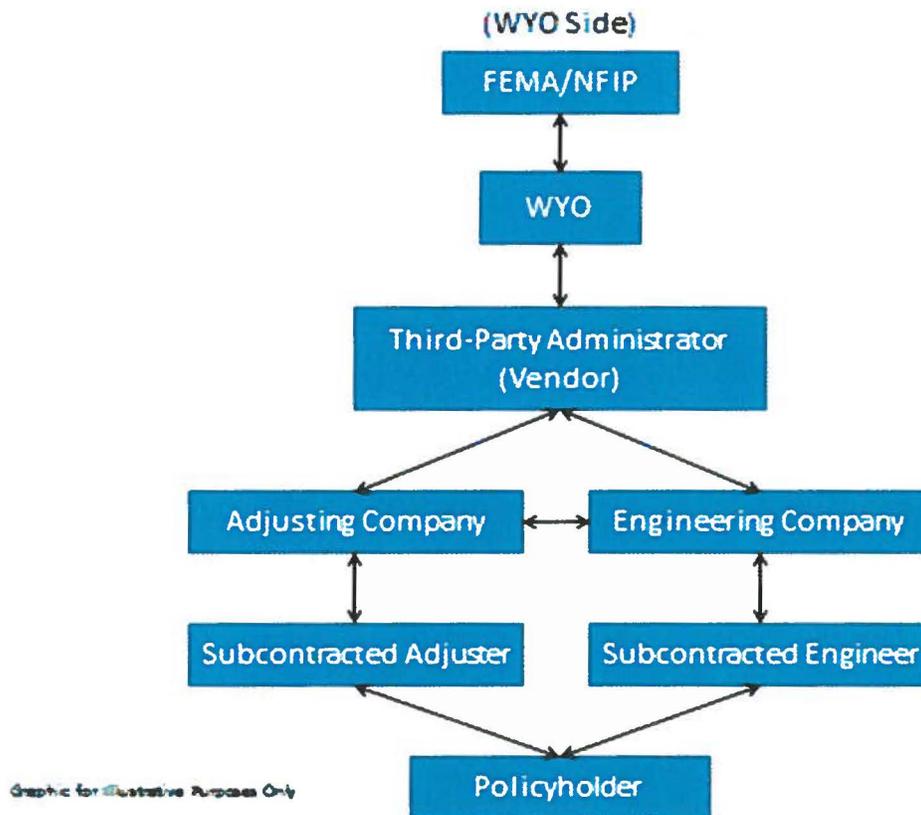
Based upon a plain language reading of the representations contained in the aforementioned exemplar marketing materials, a policyholder could easily believe that any damage resulting from “rain” or through the “freeze/thaw” process would be covered under their SFIP. However, comparison of these representations with what actually constitutes a covered “flood” for purposes of the SFIP reveals that the coverage is not nearly as broad as the marketing materials imply. For example, damage sustained from a rain event or snow melt would **only** be covered if it resulted in a (1) “partial or complete inundation,” (2) of “two or more acres of normally dry land or of two or more properties,” and (3) from an “unusual” and “rapid accumulation or runoff of surface waters from any source.” Accordingly, contrary to what the marketing materials imply, mere water inundation resulting from heavy rainfall or snow melt would not be covered. (See 44 C.F.R. Part 61, Appendix A(1), section II, Definitions.)

Despite the coverage limitations and corresponding exclusions as previously set forth, the overwhelming majority of materials utilized to sell flood insurance policies fail to detail with any degree of specificity the scope of coverage in a succinct and easily understandable format. This, of course, is unsurprising given that FEMA’s Marketing Guidelines do not appear to counsel carriers on when or how to inform policyholders of their coverage limitations and exclusions.

Administration of Claims for Structural Damage Under the NFIP

Under the “Write Your Own” Program, private insurers often contract with third-party vendors to handle the claims evaluation and payment process. Generally, following a flood event, a policy owner contacts their WYO provider, who in turn passes those claims on to the third-party vendor. The claim is thereafter assigned to a specific adjusting company, which is retained to adjust the claim and determine the amount of loss, if any, that is directly attributable to what the NFIP considers “flood” forces. The adjusting company thereafter arranges for an individual adjuster to contact the owner and inspect the property.

General NFIP Claim Management Structure



During the course of their in-person evaluation, an adjuster reviews and documents the damage to the subject property, taking sufficient measurements and relevant photographs to enable them to draft a detailed and thorough damage estimate. The adjuster report and corresponding support documentation is thereafter submitted to the insurance company (or its delegate), where the claim is reviewed and, if approved, processed for payment. Adjusters determine cost for repairs through a combination of reviewing estimates prepared by policyholders and consulting proprietary pricing software.

If during the course of the inspection the adjuster determines there is a possibility that the building structure may have been compromised as a result of the flood event, the adjusting company is generally under an obligation to request that an engineer be retained to assess the damage and determine its cause. Either an adjusting company or the overseeing WYO will contract with an engineering firm. Once retained, the engineering firm will often sub-contract with local professional engineers to conduct the actual engineering analysis and prepare an engineering report. These engineers visit the subject properties, inspect the structural integrity of the property, prepare an engineering report, and then submit that report and any corresponding support documentation, such as photographs, to the engineering firm that has employed the subcontracted engineer for review and ultimate submission to the adjusting firm. The engineering report is thereafter utilized by the adjusting company to inform the overall damage estimate. There is no current requirement obligating any of these professionals to provide a policyholder with a copy of the engineering report.

When a payment is made to a policyholder in connection with a flood claim, it is typically in the form of a check written by the WYO. According to information provided by WYO companies and their representations, the funds utilized to pay such claims are generally derived from what is in essence a joint bank account each WYO manages along with FEMA—comprised of FEMA money.

Findings

The Attorney General's investigation has revealed the existence of several fundamental flaws with the NFIP and its administration.

A. Lack of Clarity in the Scope of Policy Coverage

Contrary to what many homeowners believe, coverage under the NFIP is complex and severely limited. During the course of our investigation, it has become abundantly clear that many policyholders remain generally uneducated as to the nature and scope of coverage available under the NFIP. For example, after Superstorm Sandy thousands of policyholders initiated suits as against their respective WYO companies in Federal District Courts. The overwhelming majority of the stated complainants took issue with why, even though their homes undeniably suffered water damage, their loss was only partially covered or not at all. Our investigation has revealed that the vast majority of these lawsuits were the result of policyholders' misunderstandings (or, in some cases, disagreement) as to what is covered and what ought to be covered under a "flood" policy. In essence, policyholders argued that: (1) they purchased flood insurance; (2) their homes were subject to water damage; (3) their claims were denied in whole or in part; and (4) such denial was unwarranted.

1. What constitutes a "flood" for purposes of the SFIP is generally misunderstood.

As an initial matter, the damage sustained to a subject property is only covered in the event of a "flood" event as that term is defined in the SFIP. Unfortunately, our investigation has uncovered that many property owners fail to understand that the term "flood" as it applies to the NFIP is exceedingly specific and narrow as it applies to their coverage. Whether through their own failure to review and understand the terms and conditions of coverage, or from imprecise and potentially confusing marketing materials disseminated by WYO companies, among other things, our investigation has revealed that property owners appear to be generally unaware that "flood" as applicable under the SFIP is a defined term of art, and is not as that term is generally used and understood. As a result, policyholders are often under the misapprehension that any and all losses resulting from water inundation are necessarily covered. Policyholders are thereafter often left confused, frustrated, and angry when they learn that damage sustained to the structure of their home falls outside the scope of coverage under both the SFIP and the typical homeowners policy, despite the presence of severe water inundation.

2. The type, nature, and location of flood forces play a significant role in determining coverage for structural damage.

Even in the event of a "flood" (as that term is defined in the SFIP), our investigation has determined that policyholders are also generally unaware that the type, nature, and location of the forces generated by the floodwaters can play a significant role in determining coverage as it relates to structural damage. As set forth previously, structural coverage is, in general terms, limited to damage caused by wave

forces acting directly on a home, and does not include other structural damage caused indirectly by flood waters, such as soil erosion resulting in imbalance or collapse. Similarly, our investigation has revealed that homeowners have also expressed frustration and claimed unawareness of what constitutes part of the covered structure in the event of a flood event. For example, the location of a room relative to the home's foundation, egress, and grade can have a material impact on whether an insured is eligible to receive compensation for damage on the ground floor of a structure.

Many policyholders have expressed general awareness that structural damage attributable to preexisting conditions is excluded from coverage under the SFIP. Our investigation has revealed, however, that there can be significant disagreement between an insurer and a policyholder relating to whether observed structural damage occurred prior to, or as a result of, the flood event. Policy payments as they relate to structural damage are oftentimes denied if it is determined that inadequate construction techniques were used when the home was built, or if there was prior damage from a previous flood event. However, the NFIP does not require that properties be evaluated prior to coverage to determine preexisting construction defects or damage. Instead, the determination of what conditions may have been preexisting is made by adjusters and engineers in hindsight after a covered event, when it can be difficult if not impossible to determine which conditions were preexisting and which were caused by the current event.

3. Flood mitigation, improvements, and compliance with local ordinances and regulations are often not covered.

We also found during the course of our investigation that in many instances policyholders were surprised to find coverage to be generally limited to restoring property to its original, pre-flood condition. As a result, many policyholders fail to understand that their coverage is not designed to cover the cost of improving the structure through employing measures that may tend to mitigate flood risk, such as increasing the elevation of the foundation. Where a policyholder resides outside the above-referenced "Special Flood Hazard Area," any costs associated with bringing their home into compliance with current municipal building ordinances or other requirements to reduce future flood damage is the responsibility of the policyholder. Although policyholders in certain high-risk areas are eligible to receive up to \$30,000 to help defray the cost to bring their home into compliance they, too, must bear financial responsibility for any cost above and beyond this statutory maximum.⁷

As a result, numerous policyholders often find themselves in the untenable position of choosing either to (1) pay thousands of additional dollars out-of-pocket so as to enable them to comply with current floodplain and/or municipal ordinances and rebuild; or (2) sell their property in its current flood-damaged condition. Although the terms and conditions of coverage are specified within the SFIP itself, our investigation has concluded that policyholders are generally unaware that such reimbursable costs of

⁷ Policyholders, however, may still be eligible to receive additional assistance through other federal, state, and local governmental agencies and non-profit groups.

compliance are both finite and limited in scope.

B. Inadequate Training and Lack of Certification Requirements for Structural Engineers

FEMA requires that adjusters retained to provide services in connection with the NFIP be certified. In order to be certified by FEMA to work on NFIP claims, adjusters are typically required to have no less than four consecutive years of full-time property loss adjusting experience and attend an adjuster workshop, among other requirements. In addition, adjusters are required to take a one day “refresher” workshop each year, and must pass a written examination in order to retain their certification.

Despite this requirement, our investigation has revealed that in the wake of Superstorm Sandy, the demand for available adjusters far exceeded supply, resulting in FEMA’s Bureau and Statistical Agent (charged by FEMA as serving as a liaison between the government and the WYO companies) facilitating the “emergency” certification of adjusters through a special, truncated version of the day-long training seminar on NFIP policy coverage.

Unlike the FEMA-mandated certification requirements associated with adjusting companies, there are no such analogous provisions relating to engineer or engineering service firms. To the contrary, engineers providing services relating to NFIP claims are not subject to any type of training or certification requirements. Instead, engineers are merely subject to individual state regulations governing the practice of engineering and their respective licensure requirements. Moreover, there is no FEMA-mandated requirement that an individual assigned to evaluate a subject property be an expert in a particular discipline of engineering (such as structural engineering) or act within their respective area of competency. For example, our investigation uncovered scores of instances wherein the engineers retained to provide damage causation analyses to structures following flood events were electrical or mechanical engineers. Given the inherent unpredictability of flood events, coupled with its widespread and often devastating effects, WYO carriers are under significant pressure to quickly and efficiently process claims. Our investigation has revealed that these pressures and lack of available supply of experienced expert engineers tends to result in a wide disparity in the quality of engineering analyses.

Our investigation has also revealed that this lack of certification and corresponding training in structural damage causation analyses can often lead to incorrect or imprecise findings, which may in some instances cause policyholders to be either over- or underpaid on their respective claim. Otherwise competent engineers, unfamiliar with the mechanics of flood waters, can and do misinterpret observable data points and ascribe a particular damage causation that is unsupported by the evidence. This lack of available experienced engineers, coupled with a dearth of training and certification requirements, can and does lead to a widely-divergent quality in the underlying work product.

C. Poor Administration and Supervision of the NFIP Claims Process

Our investigation has also uncovered several systematic inefficiencies associated with the administration of the NFIP as it is currently constituted, which may tend to unwittingly result in higher costs to the Nation's taxpayers. As set forth in greater detail below, these inefficiencies include (1) the multi-tiered claims administration reporting structure, which may foster a lack of efficiency and transparency; (2) the failure to require the WYO companies and their associated administrative agents to regularly provide underlying documentation that support a particular claim and corresponding expenses incurred associated with claim evaluation; and (3) the failure to regularly and properly audit the WYO's and other policy administration service providers utilizing meaningful expense and cost datasets. Importantly, our investigation has revealed that this lack of transparency and accountability can and does lead to inflated costs for services, defrauding the federal government of possibly millions of dollars. Our investigative efforts have resulted in partnering with federal law enforcement agencies for further joint action.

1. Flow of information is inefficient.

The administration of a NFIP claim often incorporates a multi-tiered reporting structure between the WYO, adjuster, independent adjuster, engineering firm, and subcontracted engineer. As a result, the individuals and entities involved in the flood claims administrative process are oftentimes limited in their awareness of what other service providers know and are doing in connection with a particular claim. This lack of communication and general awareness on the part of the various service providers, can result in disseminating incorrect or incomplete claim-specific information during the administration process and cause confusion to the homeowner.

Our investigation has revealed numerous instances wherein the flow of information up and down the claims administration chain is materially slowed by a lack of or delay in the response to a pertinent claims-related data point necessary to move the process forward. For example, our investigation catalogued myriad instances where simple information, such as relevant contact information (i.e., telephone numbers), was miscommunicated by adjusters to engineering firms and then, in turn, to the third-party engineers retained to perform the actual inspections. This resulted in the need for third-party engineers to contact the engineering firms, who in turn would relay the request to the relevant adjusting firm. The result of this inefficient flow of information is that policyholders are uninformed about the administration and status of their claim, resulting in delay and coverage uncertainty.

Furthermore, and as described in greater detail herein, our investigation has uncovered that this multi-tiered administration can also lead to significant cost increases, as many service providers involved in the claims administration process charge markups for work performed by independent experts, such as engineers. Based on our investigation to date, many engineering service providers retained by WYO companies (or, in many instances, their third-party vendor delegate) charge a flat rate

per engineering report. However, many of these engineering firms neither perform the engineering work nor draft the structural damage assessment analyses report themselves. Instead, these services are delegated to independent engineers, which are often paid significantly less than the flat rate ultimately charged to the WYO companies. Given that these costs are ultimately borne by the NFIP, any incremental increase in the cost of services (whether legitimately incurred or otherwise), results in the fiscal drain on an already stretched and non-self-sustaining program.

When insured homeowners receive a denial or partial denial, they are typically not provided with the underlying documentation, such as the engineering report, making it difficult for them to evaluate and challenge the denial. Although Senator Gillibrand, for herself and on behalf of Senator Schumer, recently introduced a bill⁸ requiring, among other things, the policyholders be provided with final engineering and adjuster reports, there is currently no requirement that a WYO send the engineering report – or even the adjuster’s report – to the homeowner. As a result, policyholders have repeatedly stressed the need to fully understand the specific reason(s) for the claim denial decision, with all relevant supporting documentation that served as the basis for the decision appended thereto.

2. The compensation structure for engineering services is not transparent.

Adjusters are compensated for their services based on the NFIP Adjuster Fee Schedule. Although periodically amended by FEMA, the NFIP Adjuster Fee Schedule currently contains a detailed, break-point-based schedule that assigns a fee based upon the gross loss of the claim. As a result, the higher the claim, the higher the fee paid to the adjuster. (See, e.g., March 9, 2015, FEMA Bulletin Amending W-10039, Appending NFIP Adjuster Fee Schedule.)⁹

Unlike fees for adjusting services, engineering companies retained to provide expert services in connection with the NFIP are not subject to any specific fee schedule. Prior to March 9, 2015, expenses incurred by WYO companies in connection with expert services, including costs associated with retaining the services of engineers, were eligible for reimbursement without prior FEMA approval up to \$2,500. Our investigation has revealed that the overwhelming majority of expert expenses incurred by WYO companies during the October 1, 2012 through December 31, 2014 time-period fell just

⁸ On November 19, 2015, United States Senators Kirsten Gillibrand and Charles Schumer introduced a bill entitled “Flood Insurance Transparency and Accountability Act of 2015” to provide for transparency, accountability, and reform of the National Flood Insurance Program. The proposed bill, which has been referred to the Committee on Banking, Housing, and Urban Affairs, addresses *inter alia*, the issuance, timing, transmittal and prohibition on alterations of engineering reports, and also seeks to revise the scope of coverage to include structural damage attributable to earth movement caused by a flood event.

⁹ Adjusters may recover expenses in excess of the applicable NFIP Adjuster Fee Schedule if such costs were incurred to establish coverage on a specific claim, or to otherwise facilitate the adjustment. Currently, WYO companies are authorized to reimburse adjusters up to \$500 per claim, without FEMA approval. Any costs incurred in excess of \$500, must be pre-authorized by FEMA. (See April 1, 2010, FEMA Bulletin Regarding Revisions to Special Allocated Loss Adjustment Expenses.)

slightly below the \$2,500 threshold—thus circumventing the approval process that would have otherwise been required for reimbursement. Our investigative findings were confirmed by the Department of Homeland Security—Office of the Inspector General in its recently-issued report. (See DHS-OIG, *FEMA Does Not Provide Adequate Oversight of its National Flood Insurance Write Your Own Program*, OIG-16-47 (Washington, D.C.: March. 8, 2016).)

On March 9, 2015, FEMA issued a memorandum for dissemination to all WYO claim managers, compliance officers, and legal departments, announcing revisions to the manner by which FEMA will reimburse WYO companies for expert expenses, which includes engineering services. Specifically, FEMA amended its prior practice of allowing expert services reimbursement without prior FEMA approval for costs that fell below \$2,500. Effective for dates of loss occurring on or after March 9, 2015, FEMA now requires WYO companies to seek FEMA approval prior to incurring any costs associated with expert services, including engineering expenses. (See March 9, 2015, FEMA Bulletin Amending W-10039.)

Despite this, FEMA continues to not require the submission of detailed billing records in support of claimed expenditures. As a result, FEMA has virtually no way of determining whether the asserted fees associated with a particular engineering service are reasonable or disproportionate in relation to the services rendered. Under the current expense reimbursement scheme, FEMA (or, for that matter, the WYO), has no formalized mechanism for evaluating the actual cost of the expert service work performed by the authoring engineer versus any corresponding markup or associated “fee” charged by the engineering firm retained to perform the service.

Recommendations

The Attorney General regards the safeguarding of the health, safety, and welfare of the citizens of New York State and the United States and their respective properties to be of paramount interest. While there have been repeated calls for reform of the NFIP, its administration, and the scope of coverage almost since the inception of the program, few have been implemented and even fewer could be objectively considered meaningful.

Proposals for reform of the NFIP have presented themselves in many forms and have come from a variety of sources. The GAO, industry participants, FEMA officials, federal and state legislators, and individual policyholders, to name but just a few, have provided wide sweeping and varied critiques, and oftentimes have offered just as general proposed solutions. Although several proposed reforms intended to render the NFIP more efficient and transparent have been implemented over the years, many have either failed or were never put into place. One significant hurdle to the implementation of these policies may tend to be the vague, general nature of the proposed reforms, which tend to merely identify problems without offering concrete, practical, and cost-effective solutions.

To that end, the Attorney General recommends several concrete steps that federal regulators and industry participants can take to make the scope of coverage available under the NFIP and the claims administration process more transparent. In light of the findings in this Report, we believe that FEMA, the federal agency charged with administering the NFIP, should immediately implement the below-detailed reforms, most of which have little to no incremental cost associated with them.

A. Scope of Coverage and Corresponding Exclusions Should Be Transparent and Succinct, Utilizing Plain Language.

- Currently, the scope of coverage is obscured within the general policy terms of the SFIP itself.
- A plain language disclosure sheet highlighting the following should be implemented in order to bring greater transparency to the scope of coverage as it relates to structural damage:
 - What is a “flood” for purposes of coverage;
 - What type of flood forces are necessary so as to include it within the scope of coverage; and
 - What is excluded, for example:
 - Earth movement is generally excluded.
 - Cost of compliance is generally inapplicable or otherwise insufficient.

B. Expert Reports Prepared in Connection With Administering a Flood Claim Must Be Provided to the Policyholder in a Timely Manner.

- Expert reports, including both full and complete copies of final engineering and adjuster reports, with any and all corresponding attachments and support documentation, should be provided to all policyholders as a matter of course.
- FEMA can and should pass federal regulations mandating such disclosure.

C. Individuals Retained to Provide Expert Engineering Services Under the NFIP Must Be Subject to National Certification.

- Like the FEMA-mandated certification requirements associated with adjusting companies, experts retained to perform engineering services should also be required by FEMA to be certified through a combination of:
 - An initial training seminar; and
 - An annual renewal of certification through continuing education training.

D. Fees Charged for Expert Services Must Be Transparent.

- Currently, experts retained to provide engineering services are not subject to a standardized fee schedule, such as those applicable to adjusting companies.
- FEMA should institute a standardized fee schedule for all engineering services, similar to those utilized by adjusting companies.
- Additionally, engineering service providers should be required to remit supporting paperwork with their invoices to the respective WYO companies which:
 - Breaks out costs and fees incurred in subcontracting out the work;
 - Provides WYO companies, as fiscal agents of the Federal government, with a means to determine whether fees charged are reasonable in light of costs; and

- Allows FEMA to thoroughly and adequately audit expert expenses and costs.

FEMA officials were requested to review and comment on each of our proposed recommendations. A copy of FEMA's response, in its entirety, is attached hereto as Appendix A.

We are pleased that FEMA has acknowledged the importance of the issues raised by our office and has committed to undertaking measures to implement reforms designed to benefit policyholders. Specifically, FEMA has indicated that, "to the extent legally feasible," they are in the process of rewriting their manuals and communications "using a Plain English standard" with "clear definitions." FEMA has also indicated that they are implementing procedures to ensure "more visibility and insight into expert fees and bills," including "developing additional standards for NFIP insurers when obtaining outside services to ensure that costs are justified and documented."

However, although FEMA has acknowledged the importance of the issues identified by our office regarding transparency, FEMA has stated that "any document having a direct bearing on damage determination will be made readily available in a timely manner to the policyholder, *upon request*." (emphasis added) The Attorney General strongly believes that engineering and adjusting reports, and associated exhibits, prepared in connection with a claim should be provided to policyholders as a matter of course. The burden should not be shifted to policyholders to first make a demand for such expert reports.

APPENDIX A



FEMA

July 8, 2016

Stephanie Swenton
Deputy Bureau Chief
Criminal Enforcement and Financial Crimes Bureau
New York State Office of the Attorney General
120 Broadway
New York, NY 10271

Ms. Swenton,

Thank you for the recommendations from the New York State Office of the Attorney General regarding the National Flood Insurance Program (NFIP). Over the course of the last two years, we have received feedback from a number of stakeholders and are currently undertaking reform initiatives to provide our policyholders with the best possible experience.

Over the past year, the Federal Insurance and Mitigation Administration (FIMA), the component that administers the NFIP, has been undertaking a comprehensive review and overhaul of its policies, processes, manuals, and communications that focuses on improving the policyholder's customer experience with the NFIP. As a result, we have been taking considered steps to simplify our policies and processes, including for claims, policy renewal, and policy cancellation. Moreover, to the extent legally feasible, we are rewriting our manuals and communications using a Plain English standard and will include clear definitions in our manuals and communications.

We acknowledge the importance of the issues you raised regarding transparency of engineering reports and expert fees and are seeking ways to improve these processes for our stakeholders. For example, any document having a direct bearing on damage determination will be made readily available in a timely manner to the policyholder, upon request. That includes estimates, photos, diagrams, final engineering studies, or any other expert final report directly relating to damages. FEMA has also implemented measures to ensure that we have more visibility and insight into expert fees and bills, and we are developing additional standards for NFIP insurers when obtaining outside services to ensure that costs are justified and documented. It is important to note that engineers are hired for limited purposes, primarily to assess causation. FEMA is assessing measures to ensure appropriate oversight when an NFIP insurer identifies the need for engineering expertise.

We look forward to continuing to improve the NFIP in coordination with our stakeholders.

Sincerely,

A handwritten signature in blue ink, appearing to read "Roy E. Wright".

Roy E. Wright
Deputy Associate Administrator
for Insurance & Mitigation