

FEMA mulls overhaul of flood insurance program amid claims of fraud, lack of oversight

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The move, in response to allegations that claims were underpaid after superstorm Sandy, would dramatically reshape a government initiative that insures 90,000 homes and businesses on Long Island and 5.2 million nationwide.

Though the federal government underwrites flood insurance, it has long hired private companies including Allstate, Travelers and others to sell and manage policies. Those partnerships have allowed Washington to provide coverage without the staff and infrastructure of an entire insurance company. The flood insurance program, however, has been accused in government reports of exerting little oversight of the companies while paying outsized fees and bonuses. And after Sandy, federal lawmakers said the private insurers were overly focused on denying claims instead of ensuring storm victims received fair settlements.

After all of the apparent fraud, abuse and lack of oversight, we have to seriously look at and consider changing the entire model, said Sen. Kirsten Gillibrand (D-N.Y.).

Gillibrand's call to consider scrapping the system has been echoed by her Democratic colleagues Sen. Charles Schumer of New York and Sen. Robert Menendez of New Jersey.

The Federal Emergency Management Agency, which runs the flood insurance program, has asked the senators for recommendations on revamping the system. The agency, meanwhile, is conducting its own internal review.

It's unclear what might replace the system, which allows homeowners to buy the government-backed policies through the scores of different companies. Lawmakers have yet to propose an alternative, saying

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Insurance industry professionals, however, said it would be folly to terminate the flood insurance program's partnerships with private companies.

The consequences for consumers would be fewer options, less choice and dealing more directly with a government monopoly, a said Robert Hartwig, president of the Insurance Information Institute, a Manhattan-based trade group.

The debate comes as FEMA is in talks to settle roughly 1,800 lawsuits filed by homeowners claiming they were underpaid on flood insurance claims after Sandy. Later this month, the agency is launching a process to reopen claims for the other 142,000 policyholders flooded in the 2012 storm.

Subsidizing since 1968

The National Flood Insurance Program began in 1968 after private companies concluded the business was too risky and stopped offering coverage at prices most homeowners could afford.

So Washington offered policies at subsidized rates. Instead of hiring an army of actuaries and adjusters, the government outsourced. Essentially, Washington agreed to accept the risk of paying settlements and farmed out the grunt work to the private sector.

Today, 83 different companies handle policies through the outsourcing program. For most homeowners those private insurers are the face of flood insurance. They sell policies and collect premiums. When storms hit, the companies dispatch adjusters and determine how much Washington should pay for damages.

The companies are paid based on the number of policies they sell and manage. And they are reimbursed for calculating settlements.

The outsourcing system is named the Write Your Own Program because companies write policies themselves and has been credited with increasing the number of flood insurance policies sold nationwide. It also has been a lucrative side business for companies, which profit from policies without the risk of paying billions in settlements from their own pockets after major floods.

Yet, the system has also drawn criticism.

In 2007, the Government Accountability Office issued a report saying FEMA paid the private companies more than one-third of every dollar it collected in premiums, based on an antiquated compensation structure developed 25 years earlier. The reports also faulted the agency for not collecting data on the companies' actual costs of performing the work. Nor did FEMA consistently audit the insurers, the GAO found.

Pivotal photo of report

Then came Sandy, and a single photograph set off cries to reform the flood insurance program that have echoed from Long Island to Washington.

Weeks after the storm, a Long Beach homeowner was outraged when his insurance claim was denied because an engineer blamed damage to the house on long-term erosion rather than flooding.

So he asked for a second inspection. When the engineer returned, he told the homeowner that a supervisor had edited his report, removing any acknowledgment of flood damage. The engineer pulled out an unedited draft, and the homeowner snapped a picture.

That photograph prompted a hearing last year in federal court, where a judge concluded engineering firms may have regularly altered reports. Within weeks other homeowners came forward with allegations.

The New York State attorney general opened an ongoing criminal investigation. Two top officials at the flood insurance program stepped down. And FEMA vowed to undertake sweeping reforms.

Advocates for homeowners blame the alleged wrongdoing, in part, on the outsourcing program. The private companies, they say, exercise too much influence over flood insurance and have introduced a corporate style of adjusting claims, exploiting loopholes to avoid paying settlements and then aggressively fighting homeowners in court.

That push to pay as little as possible, advocates said, led engineering firms to alter reports in hopes of currying favor with insurers.

The culture of the insurance companies has infected the flood insurance program, a said Amy Bach, executive director of United Policyholders, a San Francisco nonprofit that helps homeowners file insurance claims after disasters.

Insurance companies deny underpaying claims, saying the move would cost them customers. The official appointed by FEMA to overhaul the flood insurance program, Brad Kieserman, said he has seen no evidence of wrongdoing by insurers who handled Sandy claims.

Buffer can hinder FEMA aid

FEMA has, however, acknowledged problems with the outsourcing program's structure. The companies act as a buffer between FEMA and policyholders, making it difficult for the agency to communicate directly with homeowners. And data collection which is crucial for calculating insurance risks is difficult with 83 different companies.

For instance, when the fraud allegations arose, FEMA could not initially say how many claims involved engineering reports. The agency had to ask the companies.

Maybe that's not the best basis for the business model, Kieserman said in an interview.

FEMA has authority from Congress to run the flood insurance program with or without the private companies, Kieserman said. The agency already manages nearly 1 million policies itself. So ending the outsourcing program wouldn't mean starting from scratch.

Yet, insurance industry professionals say FEMA can fix the outsourcing program's shortcomings without abandoning it entirely. Hartwig, of the Insurance Information Institute, said the agency should instead focus on the \$23 billion debt that the flood insurance program has racked up after years of subsidizing policies.

Past attempt at reform

The flood insurance program has jettisoned its private partners before.

In 1977, officials concluded that the 132 companies managing policies at the time were overcharging the

government and underpaying homeowners. So the program's director, J. Robert Hunter, cut ties with the companies.

Rather than deal with a constellation of insurers, Hunter put a massive contract out to bid for a single company to manage every flood insurance policy in America. The winner was Electronic Data Systems, a technology company founded by Ross Perot, who would later become an independent presidential candidate.

In an interview this week, Hunter said the move saved the flood insurance program millions of dollars. He also said dealing with a single company made it easier for the government to ensure storm victims were fairly paid.

The arrangement, however, was temporary. A federal audit later found that Electronic Data Systems 'neglected fundamental accounting responsibilities' and issued reports that were riddled with errors. In 1983, the flood insurance program launched its current system, outsourcing the work to scores of insurers. Hunter said it's time to rethink that move.

It would be a blessing if they got rid of the program, said Hunter, now the director of insurance for the Consumer Federation of America. It would save money. And claims would get paid.