



A REPORT TO  
THE MARYLAND CONGRESSIONAL DELEGATION  
ON HURRICANE ISABEL

MARYLAND INSURANCE ADMINISTRATION

MARCH 4, 2004

Alfred W. Redmer, Jr.  
Insurance Commissioner  
State of Maryland

## **Introduction**

The devastation Maryland experienced on September 18 and 19, 2003 as a result of Hurricane Isabel included unprecedented damage to property along the waters of the Chesapeake Bay. We have seen first-hand the loss of homes, cars, personal possessions and commercial properties. And, we have heard and shared the frustration of those whose attempts to rebuild their lives have been made even more challenging because of difficulties in dealing with their insurance companies -- and with the National Flood Insurance Program (NFIP).

The Maryland Insurance Administration (MIA)'s role in the case of an emergency that involves insurance is to help citizens by informing them of their rights and coverages under their insurance policies and to assist them when they have problems with their claims.

In the weeks and months following the storm, the MIA's outreach efforts focused on staffing each of the 15 Disaster Recovery Centers (DRC) that opened around the State and coordinating and co-sponsoring nine public meetings within affected communities. In order to speed up the existing formal Complaints process, which can take months to achieve a resolution, an Intake system was created. As a result of that effort, MIA staff opened Intake files on 1,321 storm victims they met face-to-face at the DRCs, at community meetings or when they called into the MIA. Policyholder's insurance company were immediately called by a member of the MIA staff in an effort to resolve the insured's concerns. In some cases, claimants' questions and concerns were satisfied with a couple of telephone calls. In other cases, resolution took longer and was more involved. Out of the total 1,321 Intakes, only 280 became formal Complaints and of those, 195 were closed by February 28.

Closing such a high number of Intakes before they became formal Complaints shows how successful the Intake process was. Putting these numbers into perspective, in 2003 there were 20,000 complaints for other Property and Casualty issues. Each Complaint could take several weeks to several months to investigate. Being able to intercede before the Isabel problems became formal Complaints and being able to deal with those problems so quickly, meant that literally hundreds of people were assisted in a very short time.

While many of the issues raised by citizens in the Intake process centered on homeowners insurance questions, the vast majority of problems concerned the NFIP policies and coverage.

To put Hurricane Isabel into perspective with other Federal flood claims from Maryland in the past 25 years, flood claims usually totaled fewer than 500. There were more than 1,000 claims in only two of those years (1979 with 1,067 claims and in 1996 there were 1,370 claims). Total claims pay-outs topped \$1 million in only in eight of those 25 years (1979-\$8.9 million, 1984- \$2.89 million, 1985- \$5.75 million, 1989-\$1.45 million, 1992-\$4.57 million, 1996-\$12 million, 1998-\$2.6 million, 1999-\$4.6 million). In 2003, a total of 6,323 claims have so far topped \$102,258,000 in payments to policyholders. Hurricane Isabel claims account for just about one-half of all claims to the Federal flood program since 1975, (6,323 for Isabel, 13,009 total claims since 1975).

## **The NFIP and the Jurisdictional Issue**

Congress established the National Flood Insurance Program (NFIP) under the National Flood Insurance Act of 1968 in order to make flood insurance available, on reasonable terms and conditions, to those in need of such protection in any part of the United States. As a Federal program, it is under the jurisdiction of Congress and regulations promulgated by the Federal Emergency Management Agency (FEMA).

Both in response to complaints filed in 1999 after Hurricane Floyd and to complaints filed in 2003 after Hurricane Isabel, the MIA has consistently taken the position that it does not have jurisdiction over claims submitted by Maryland policyholders under policies issued under the NFIP's Write Your Own (WYO) program.

First, Federal statutory law and regulation, as well as Federal case law, expressly provides that Federal law governs Federal flood insurance policies. Thus, all actions on such policies must be brought in Federal courts, which apply Federal law to the construction of policy terms and conditions. Second, it is well recognized that Federal law preempts the application of any state law or action against a WYO carrier in connection with the handling or payment of a Federal flood claim. FEMA actually revised its regulations effective December 31, 2000 in order to clarify that any matters "relating to and arising out of claims handling" are "governed exclusively by Federal law."

An exception to the general preemption rule does exist with regard to misrepresentation. The MIA may take regulatory action against insurance producers and insurance carriers with regard to misrepresentations made at the time that the policy was sold. Such cases, however, are very difficult to prove, particularly when the policy was sold many years before and documents may no longer be available or memory may be unclear.

Recognizing that the MIA's knowledge of the Federal program was limited, Commissioner Redmer scheduled a training session for key members of his staff 10 days after the Hurricane. The NFIP Regional III Manager led the training session on a Sunday afternoon to review the program, explaining what it covers and what it does not. The Commissioner was clear from the outset that the MIA would be the entry point for any insurance questions or concerns, whether or not the MIA had authority to regulate the handling and payment of the claims.

In addition, MIA employees from various internal Units voluntarily "transferred" to the Consumer Complaints Unit to help staff the Agency's response growing out of the storm. Some employees worked at the 15 DRCs (sites were open seven days a week for an extended period of time) and some filled positions internally for those who were out in the field. In all, more than 70 people out of a total Agency population of 300 directly participated in the effort to assist Maryland citizens. Everyone who worked at a DRC was trained in the Federal program so they would be able to help citizens sort out their insurance problems.

Although hampered in its ability to step in to help solve NFIP claims issues directly because of Federal preemption, the MIA still went out of its way to develop a relationship with NFIP staff to help facilitate closure of claims for Maryland citizens. This new relationship has meant repeat appraisals for some policyholders and increased insurance pay-outs for others. The MIA is appreciative of the response of the NFIP in these cases.

## **What Needs to Happen Next**

Maryland's recent experience has shown that greater attention by both the State and Federal government needs to be shown to the flood insurance program -- how it is marketed and sold, what training the sellers should have before being able to sell the product, what coverage should be provided by the policy, how the claims process is handled, and what recourse policyholders have if they are dissatisfied with the outcome.

Moreover, the issue of NFIP policy compliance in relation to mortgage loans must be addressed. In as much as Congress has declared that everyone in a floodplain has to have flood insurance, it is not acceptable for there to be even one Isabel-damaged property that should have had flood insurance and did not. Nor should there be a homeowner without an adequate amount of coverage because the mortgage company didn't know what was required. Unfortunately, there were many of both. Greater lender education and involvement is critical to the success of the program and to the insurance security concerns of Marylanders.

In order to also cover property owners who, for one reason or another, have no mortgage, there needs to be a requirement that property owners in a floodplain are notified of the flood insurance requirement. Notification could be handled at the local level through tax assessment notices, but the Federal program should required that this happen.

In addition, when FEMA changes a flood zone, all property owners in affected zones need to be notified by certified letter from FEMA. Currently, the burden falls on the property owner to know if the property is in a flood zone. If at the time of sale of the property the site is not in a flood zone, but subsequently FEMA places it in a flood zone, the owner has no way of knowing. FEMA could notify local jurisdictions who would then be required to send the status change with property tax bills. Also, this information must be readily available at the time of a title search.

The MIA recommends that Federal officials work more closely with the Banking and Mortgage industry concerning the amount of flood insurance required in relation to the amount of the mortgage. Specifically, while mortgage lenders require flood insurance to cover the value of the mortgage, which includes the value of the structure AND the land, the NFIP policy only covers damage to the structure. So, although a policyholder may be required to pay for an insurance policy based on the full value of a mortgage, that policyholder can never recover the full value of the policy because some of it covers the value of land which is not covered under the policy. In the case of Hurricane Isabel, we have discovered that some people were "over insured" and paying for an amount of coverage they could never recover under any circumstances.

The Maryland Insurance Administration has, and will continue, to work with storm victims to help resolve their individual problems with their insurance companies, FEMA, and the NFIP. While the MIA can act as an advocate on behalf of individuals in their specific cases, this experience has revealed that there are broader, systemic problems that must be addressed in order to protect our citizens in the event of future disasters.

Given our current experience with the NFIP, a list of recommendations has been developed.

**The Maryland Insurance Administration suggests FEMA, through the NFIP should:**

*At the time of the sale of the policy,*

- Require Write Your Own (WYO) companies to audit policies at the time they are purchased to make certain appropriate rating and classification criteria (such as flood zone designation) have been applied and appropriate premium has been charged. Failure to perform the audit would preclude the company from charging additional premium at the time a claim is made.
- Assure that there is full disclosure of the difference between contents and structural coverage by requiring the signature of the insured on the application or other documents that explain and waive contents coverage.
- Assure that consumers understand how the Increased Cost of Compliance (ICC) coverage works. At the time of sale, there needs to be a written document given to the purchaser that explains what ICC includes (whether it includes stairs, garage doors, flood vents, steel beams, etc.), that the ICC payments will be paid out in increments not all at once if there is a claim, that the ICC coverage is not a flat \$30,000 guaranteed payment for compliance costs but could be deemed to be less, etc.
- Provide to policyholders at time of sale, a Frequently Asked Questions ("FAQ") booklet or another easy to understand document that explains what is and what is not covered by the flood policy and how claims will be handled and paid under the policy. There should be a place on the document the purchaser signs where there is also a sign-off that the FAQ and ICC materials were given.
- Explain that a 30-day underwriting waiting period exists before the coverage becomes effective, unless the property is newly purchased and the policy must be procured in accordance with federal lending requirements.
- Assure that policyholders understand how the depreciation system works, i.e. that full replacement cost will not be paid until repair or rebuilding work is completed. This could cause a cash flow problem for the policyholder if damage is incurred.

***In addressing the coverage currently provided by the policy,***

- Conduct an exhaustive review of the terms and conditions of the policy in light of the types of properties located in the flood zones, (i.e. those with oil tanks located on the outside of the dwelling), the value of the properties and the coverage provided (i.e. no coverage for contents in basement or lowest level). The review should include an analysis of the items that are currently covered and excluded.
- Reassess the requirement that in order to get a Small Business Administration (SBA) loan, an NFIP policyholder who did not previously have contents coverage may be required to purchase a contents policy even if the structure is not currently inhabitable and there is no contents to insure at that point.
- Conduct a review of the policy provision that allows the insurance company to delay the settlement of a claim relating to the loss of contents pending the resolution of a claim relating to damage to the insured structure.
- Add in the cost of the sales tax required to pay for items when determining the total payment. Currently, the policy only pays for the actual cash value of replacement materials. When the policyholder or contractor purchase materials to rebuild, they have to pay the sales tax over and above what payment the policyholder has been given. This is a critical difference for people who are already strapped for cash.
- Consider amending the portion of the policy which states that repair or rebuilding of damaged or lost property will be made with material of "like kind and quality or its functional equivalent" by deleting the "functional equivalent" statement. It is unreasonable to expect that when people make an investment to upgrade their property and are paying added insurance to cover the value of that upgrade (and more of a mortgage), that they will not be compensated accordingly if there is a loss. An example is a kitchen with granite countertops which is valued by the appraiser for the value of Formica countertops. Both are functional equivalents, but while they may be "like kind," they are certainly not "like quality."

***In review of the claims process,***

- Establish a time deadline for inspection of damage and for the settlement of claims. The MIA received numerous inquiries and complaints because of the time it took adjusters to conduct initial inspections of properties, the time it took for adjusters to return with a proof of loss statement, the time it took for an offer of settlement to be made, and the time it has taken for a final check to be issued.
- Require the Single Adjuster Program to prevent consumers' confusion in dealing with multiple adjusters and to assure consistency in the claims handling process.

- Require that, when a claim is made, companies immediately provide the claimant with a document that explains in clear and simple language the claims adjustment process, including how the claimant can challenge the decision of the original adjuster.
- Create a formal appeals process for policyholders. Tell policyholders *in all printed materials* that they are entitled to ask for a General Adjuster to review the insurance company's adjuster's decision. Currently there is NO formal appeals process for policyholders who do not agree with the decision of the insurance company adjuster. There is no way for citizens to voice their dissatisfaction with the process, no way to see if their claim was received, no way to find out at where in the adjudication process their claim is, or no way to determine when they can expect to get an answer on the claim. In fact, the NFIP policy itself has neither a telephone number to call nor address to write directly to NFIP for inquiries.
- Require that claim denial letters give clear and specific explanations of the basis for the denial and include instructions for contesting the denial.
- Consider changing the depreciation portion of the policy so the policyholder is not caught short because payment for replacement value is a depreciated amount. In most cases, policyholders cannot pay contractors the difference (replacement cost minus depreciation cost) as they wait for their work to be completed and NFIP to pay the depreciation amount that has been held back.
- Consider changing the Proof of Loss timeframes. There also needs to be greater detail given concerning the parameters of the limits and the procedure for getting extensions of those limits.
  - Currently, a victim has 60 days from the time an offer of settlement is made to sign a Proof of Loss statement. Depending on the time of the year, the location of the property, the volume of damaged properties in an area, etc., a policyholder may not be able to get a contractor to come out and give an estimate of the cost of repair or replacement of a structure within 60 days. Given the rural setting of some of the Hurricane Isabel damaged properties, the 60-day limitation was impossible.
  - Currently, a victim has 180 days to get reimbursed by NFIP on "recoverable depreciation" (for work that has been completed). Again, depending on time of year, location, etc., work may not be completed in 180 days. People need to be told up-front that they can get an extension and how to do so.
- Require that people be told that even after they sign the proof of loss statement, they can reopen their claim if material and building costs go up. Policyholders can ask for a variance (with receipts for proof), even after construction has been completed, but many do not know this.

- Require that either the proof of loss statement or additional printed materials tell people to make copies of all paperwork before sending it back to NFIP or the insurance company. While it may seem like common sense to make copies of paperwork, people suffering the effects of a disaster may not be thinking clearly enough to do a seemingly simple thing such as this.
- Require the company to secure, at its own expense, an inspection of the property by a structural engineer when ICC coverage is at issue.

*In review of the education requirements for sellers and buyers,*

- Require that minimum educational standards be established for producers and adjusters working for all WYO companies participating in the program.
- Require that consumer education be provided by the producer at the inception of the policy, and Question and Answer documents, newsletters, etc. should be sent at renewal to the consumer. Flood damage mitigation and prevention tips should also be provided.

**The MIA acknowledges that subsequent to the Hurricane, at the request of Commissioner Redmer, NFIP staff held five free training sessions for insurance producers at four locations around Maryland. At those training sessions, 182 producers completed the course. Additional sessions will be planned by NFIP and supported by the MIA.**

*In the body of the policy or on a printed attachment to the policy,*

- Require specific instructions that explain what a policyholder's appeals rights are, including what legal action can and cannot be taken against the WYO, FEMA, or NFIP. While FEMA may believe the National Flood Insurance Act made clear that Congress intended lawsuits only on a disallowance of a claim and that by creating the WYO program they did not intend to expand the areas in which policyholders could bring suit, insureds do not understand the narrow interpretation of sovereign immunity in these cases.
- Require contact information, including a telephone number and email address that policyholders can use if they have questions concerning coverage or the appeals process. The lack of any contact information forces the policyholders to turn to their local regulators who don't have jurisdiction or the WYO companies who may or may not know how to answer their questions.

## **Other FEMA/NFIP/SBA Observations**

Because MIA personnel were at every location of the DRCs for every hour they were open, certain observations were made about the FEMA and the Small Business Administration (SBA) response. While we are grateful for the time the FEMA, NFIP, and SBA employees spent in our State trying to help citizens in this most critical time, inconsistencies in their messages only confuse people and may, in the long run, not get the right help to those who need it most.

The following are some of these observations, both positive and negative.

- In one DRC, the FEMA manager turned people away who had not yet called the toll-free telephone number to get a FEMA registration number. He would not let anyone use the telephone there. This was particularly difficult for those who had no home to call from and no cell phone to use. In another DRC, the FEMA manager let people use the telephone to call the toll-free telephone number and get registered.
- In one DRC, the FEMA manager held daily meetings at 8:30 a.m. (before the Center opened) for all of the participating staff, so everyone could share information with each other. In that way, each agency or program represented learned what the others were doing and how they would be able to help victims. The MIA staff person at that DRC thought it was very helpful.
- Some FEMA mitigation personnel volunteered information to victims about mold remediation, bringing it up even if the homeowner did not, while others did not seem to go out of their way to stress what help and information was available.
- At one DRC, the SBA representative was not aware of a program available to help people recover lost wages. A paper on the wall at the FEMA manager's desk explained what was available, the deadline, and where to call. The SBA representative said people had asked, but she hadn't known there was a program to tell them about. This was four weeks after the storm, after many victims had already been through the Center, and after many people had asked her for help which she was not able to give.
- There was no full-time NFIP representation at the DRCs. So, NFIP information and guidance was often provided by other FEMA representatives who may not have had any flood insurance training. Given the nature of this event, specific, consistent NFIP information was critical to the victims.
- Several of the NFIP representatives at the DRCs were knowledgeable, but somewhat defensive, in their conversations with victims. They could quote regulations supporting an NFIP decision without explaining why those regulations were in place. In this sort of event, people need to understand why certain decisions are made, not be lectured to about regulations.
- There was a misunderstanding about qualifying for, applying for, and getting ICC funds through NFIP. Victims were told they had to get "substantial damage" certifications from their County governments. Unfortunately, few were told or knew where in County government to go to get what they needed. In this sort of event, FEMA should coordinate information with the local jurisdictions, so the FEMA personnel know where to direct victims.

- Victims have recognized that people who had flood insurance are getting less monetary assistance from FEMA than those people without flood insurance. People without flood insurance are getting up to \$5,000 for their lost possessions, while those with flood insurance and no contents coverage are getting nothing.
- Victims have recognized that no one is receiving the full \$25,000 amount FEMA representatives told them was available at public meetings and at the DRCs. Most victims in Baltimore County say they are getting no more than \$13,000 in assistance.
- SBA subtracts whatever amount a victim has been paid from FEMA. Those early payments went to cover daily living expenses, etc., but are being subtracted from the eventual rebuilding and rehabilitation loans. People need the full amount of the loans to cover their costs.
- The locations and times the DRCs were open were not sufficiently advertised after their initial opening announcements. Weeks after the storm, people were saying they didn't know where to go or that there was even a place to go to get help.
- Sometimes, there was not enough coordination and communication between the Disaster Field Office (DFO) and the DRCs. In one instance, two mini-DRCs opened in lower Dorchester County on a Saturday and the FEMA manager at the main Dorchester DRC didn't know until late that afternoon that they had opened. No other information, including location, was available.

## **Comments from the Insurance Industry**

In addition, the MIA has received the comments listed below which are recommendations from the insurance industry. These comments should be explored with representatives from industry and the NFIP to determine whether these changes would benefit the policyholders.

- NFIP education for claim adjusters and agents needs to be tailored to the different skill levels, abilities and experience of adjusters and agents. Current educational programming is general and does not serve the needs of all agents and adjusters. At a minimum, there should be two levels of claims adjuster training classes: a basic class covering policy fundamentals and an advanced class incorporating complex claim handling, litigation issues, and file examination & exception trends. The materials need to be updated and maintained as changes are made to the Flood Program. Simple job aids should also be created.
- NFIP should expand the Preliminary Report completed by the claims adjuster to capture more of the critical rating factors relevant to the damaged property to ensure consistency in property description (such as dimensions, elevation, number of vents, etc.).
- NFIP should increase its allowance for expenses (such as cost for photographs) to validate property descriptions at the time of initial policy underwriting/issuance.

- To assist insurers in the deployment of claim adjusters for large catastrophic events, NFIP should assemble and distribute actual industry and NFIP data regarding the location and severity of loss at the onset of a large event, rather than relying on computer models.
- Increase initial claims capacity by encouraging and coordinating the development of inside (telephone) claims handling (education of techniques, development of best practices, and establishing clear method of inspection limits).
- The approval process for payment of SALAE (supplemental allocated loss adjustment expense) should be more mechanized and timely.
- NFIP should work with the insurance industry to develop a process for electronic filing and storage of claim files and supporting documentation.
- NFIP response time to WYO company and flood vendor inquiries, whether via e-mail, mail, or phone, should be quicker.
- All flood program requirements, clarifications and expansions must be in writing.
- Flood program changes are often not provided with sufficient advance notice for insurers to comply; new rating information should be sent via a rate file rather than PDF.
- Communications from NFIP should be electronic, rather than regular mail.
- When flood zones change, insurers should be provided with a file identifying all policies for which the zones have changed. This will allow WYO companies to mechanically update policies at the following renewal.
- All flood program Rules/Requirements should be reviewed in their entirety and simplified where the complexity is not warranted.
- It is recommended that NFIP assess whether there is a continuing need for Submit for Rating.
- Agents should be required to be certified to write flood policies.

## **Conclusion**

The MIA has a rather unique perspective on the workings of the DRCs, because it staffed all of the DRCs at all times. It was MIA staff who gathered information at various locations about available programs and services, and then reported back to the MIA Associate Commissioner for Complaints in Baltimore. She then distributed the information, much of it not insurance related, back out to all of the MIA staff in the field. What became very clear early on, was that if the MIA didn't coordinate and distribute these messages to each of its staff members, important information would not have gotten to the people who needed help.

Because the FEMA employees work at one disaster after another around the country, it might be helpful if they received an orientation as a group when they are assigned to a new disaster location to help assure that their messages are uniform and appropriate for that disaster and jurisdiction. One would think the communication by FEMA/NFIP/SBA personnel would be consistent, but it was obvious that the level of training provided to such personnel (and thus the scope and accuracy of the information they could provide) varied greatly.

This report makes several suggestions that are intended to improve the Federal Emergency Management Agency's National Flood Insurance Program and its relationship with policyholders, producers, and the insurance companies that sell the Federal flood insurance product. The Maryland Insurance Administration stands ready to work with FEMA, the NFIP, and the Maryland Congressional Delegation to accomplish these goals. These policyholders and producers are our constituents. If this experience has taught us anything, it is that we must raise the awareness and understanding of flood zone property owners and educate the insurance industry on the policy and claims process.

***Respectfully submitted,  
Alfred W. Redmer, Jr., Maryland Insurance Commissioner  
March 4, 2004***