

FEMA Does Not Provide Adequate Oversight of Its National Flood Insurance Write Your Own Program





DHS OIG HIGHLIGHTS

FEMA Does Not Provide Adequate Oversight of Its National Flood Insurance Write Your Own Program

March 8, 2016

Why We Did This Audit

The Federal Emergency Management Agency (FEMA) requested that we audit its oversight of the Write Your Own (WYO) program to help identify actions FEMA can take to better perform oversight functions.

What We Recommend

We made seven recommendations to FEMA, which include advisement that FEMA establish procedures to evaluate the effectiveness of the WYO program; and develop procedures, guidance, and instructions to improve its oversight of the program.

For Further Information:

Contact our Office of Public Affairs at (202) 254-4100, or email us at DHS-OIG.OfficePublicAffairs@oig.dhs.gov

What We Found

FEMA does not provide adequate oversight of the WYO program under the National Flood Insurance Program (NFIP). Specifically, FEMA is not using the results from its Financial Control Plan reviews to make program improvements; is not performing adequate oversight of the Special Allocated Loss Adjustment Expense reimbursement process; and does not have adequate internal controls to provide proper oversight of the appeals process. These conditions exist because FEMA does not have adequate guidance, resources, or internal controls. As a result of this inadequate oversight, FEMA is unable to ensure that WYO companies are properly implementing the NFIP and is unable to identify systemic problems in the program. Furthermore, without adequate internal controls in place, FEMA's NFIP funds may be at risk for fraud, waste, abuse, or mismanagement.

FEMA Response

FEMA concurred with all seven of our recommendations and has already begun implementing corrective actions.



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Department of Homeland Security

Washington, DC 20528 / www.oig.dhs.gov

MAR 8 2016

MEMORANDUM FOR: Roy E. Wright
Acting Associate Administrator
Federal Insurance and Mitigation Administration
Federal Emergency Management Agency

FROM: Mark Bell *Mark Bell*
Assistant Inspector General for Audits

SUBJECT: *FEMA Does Not Provide Adequate Oversight of Its
National Flood Insurance Write Your Own Program*

Attached for your action is our final report, *FEMA Does Not Provide Adequate Oversight of Its National Flood Insurance Write Your Own Program*. We incorporated the formal comments provided by your office.

The report contains seven recommendations aimed at improving the Write Your Own program under the National Flood Insurance Program. Your office concurred with all the recommendations. Based on information provided in your response to the draft report, we consider all recommendations open and resolved. Once your office has fully implemented the recommendations, please submit a formal closeout letter to us within 30 days so that we may close the recommendations. The memorandum should be accompanied by evidence of completion of agreed-upon corrective actions and of the disposition of any monetary amounts.

Please send your response or closure request to
OIGAuditsFollowup@oig.dhs.gov.

Consistent with our responsibility under the *Inspector General Act*, we will provide copies of our report to congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Please call me with any questions, or your staff may contact Maureen Duddy, Deputy Assistant Inspector General for Audits, at (617) 565-8723.

Attachment



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Background

Congress established the National Flood Insurance Program (NFIP) in 1968. NFIP provides flood insurance for purchase to property owners against the risk of property damage or loss resulting from floods occurring in the United States.¹

The Federal Emergency Management Agency's (FEMA) Federal Insurance and Mitigation Administration (FIMA), through its Risk Insurance Division, is responsible for oversight of the NFIP program. FIMA provides affordable flood insurance for property owners and encourages communities to adopt and enforce floodplain management regulations that mitigate the effects of flooding on new and improved structures.

As part of the NFIP, the Write Your Own (WYO) program began in 1983 as a cooperative arrangement between FEMA and the private insurance industry. It allows participating property and casualty insurance companies to write and service FEMA's Standard Flood Insurance Policy in their own names. As of October 2015, there were 79 companies participating in the WYO program and handling the majority of flood insurance policies under the program. FEMA's NFIP Direct² program administers a small number of policies and is not within the scope of this audit. For flood events occurring between October 2012 and December 2014, the WYO companies received 162,500 claims and paid \$7.8 billion to policyholders.³



Source: FEMA

Under the WYO program, FEMA enters into an arrangement with private insurance companies that are authorized to engage in the business of property insurance. The arrangement allows the companies to offer flood insurance coverage to eligible property owners. Under the arrangement, a company

¹ "United States" includes the States, the District of Columbia, the territories and possessions, the Commonwealth of Puerto Rico, and the Trust Territory of the Pacific Islands.

² Flood insurance coverage written directly with FEMA and not affiliated with a WYO company.

³ Totals through January 2015.



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participating in the WYO program arranges for adjustment, settlement, payment, and defense of all claims arising from the flood policy. FEMA reimburses the company for claims paid to property owners and compensates the company for its expenses. For the insured, FEMA has established an appeals process in cases where the claim is denied in whole or in part.

FEMA established the Financial Control Plan, which is meant to account for and ensure appropriate spending of taxpayer funds. WYO companies must adhere to the requirements outlined in the Financial Control Plan. To ensure these requirements are being met and to assess the performance of WYO companies, FEMA has developed various oversight and monitoring activities as part of the plan, which include the following:

1. Claims and Underwriting Operation Reviews,
2. Biennial Financial Audits,
3. Claims Re-inspections, and
4. WYO Standards Committee Reviews.

FEMA provides reimbursement to the WYO companies for the following types of compensation:

Table 1. Types of Compensation

Compensation Type	Description
Operating and Administrative Expenses	Reimbursement of marketing, operating, and administrative expenses.
Commission Allowance	Allowance to meet commissions or salaries of insurance agents.
Growth Bonus	Increase in compensation dependent on the extent to which the Company meets the NFIP marketing goals.
Allocated Loss Adjustment Expenses (ALAE)	Standard amount of compensation for each individual claim.
Unallocated Loss Adjustment Expenses (ULAE)	General overhead (indirect expenses) for settling losses.
Special Allocated Loss Adjustment Expenses (SALAE)	Direct expenses that are above what is covered by ALAE.

Source: OIG Analysis of 44 Code of Federal Regulations Part 62, Appendix A, *Federal Emergency Management Agency, Federal Insurance Administration, Financial Assistance/Subsidy Arrangement* and related guidelines issued by FEMA.

This audit primarily covers SALAEs, which have four different types: expert,⁴ adjuster, litigation, and appraisal. In the aftermath of Hurricane Sandy, which struck in 2012, FEMA management and Congress raised concerns regarding SALAEs. The specific concerns centered on litigation and engineering expenses incurred by WYO companies. In response, FEMA established a task force in February 2015 to expeditiously resolve litigation from Hurricane Sandy claims and offer all policyholders who believe they may have been underpaid the

⁴ Expert expenses include engineer, surveyor, and Certified Public Accountant (CPA) expenses.



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opportunity to have their claims reviewed. Our audit did not review the task force's review of litigation arising from Hurricane Sandy⁵ or the Hurricane Sandy review process.⁶

Results of Audit

FEMA does not provide adequate oversight of the WYO program under NFIP. Specifically, FEMA is not using the results from its Financial Control Plan reviews to make program improvements; is not performing adequate oversight of the SALAE reimbursement process; and does not have controls to provide proper oversight of the appeals process. These conditions exist because FEMA does not have adequate guidance, resources, or internal controls. As a result of this inadequate oversight, FEMA is unable to ensure that WYO companies are properly implementing NFIP and is unable to identify systemic problems in the program. Furthermore, without adequate internal controls in place, FEMA's NFIP funds may be at risk for fraud, waste, abuse, or mismanagement.

Financial Control Plan Required Reviews and Results

FEMA performs reviews required by the Financial Control Plan, but the process can be improved. For example, FEMA has established a WYO Standards Committee; is performing re-inspections and triennial claims and underwriting reviews; and is requiring biennial audits as stated in the regulations. However, there is no evidence that FEMA is using the results of the oversight activities performed to improve the NFIP WYO program. According to the Government Accountability Office (GAO),⁷ management should evaluate and document the

FEMA management acknowledges that NFIP has no consistent or reliable method to identify systemic problems or recognize patterns from warning signs.

results of monitoring and evaluations to identify internal control issues, and then use those evaluations to determine the effectiveness of the internal control system. Yet, FEMA management acknowledges that NFIP has no consistent or reliable method to identify systemic problems or recognize patterns from warning signs.

Special Allocated Loss Adjustment Expense Reimbursement Process

FEMA is not performing adequate oversight of the SALAE reimbursement process. Specifically, FEMA did not require the review of SALAE expenses below established dollar limits, and its reviews of payments above those limits were not thorough. SALAEs are reimbursable expenses incurred by a WYO insurance company on behalf of the NFIP. These expenses are categorized into

⁵ Hurricane Sandy Settlement Process – Payment of Litigation Expenses (FEMA Bulletin W-15009)

⁶ Superstorm Sandy Review Process (FEMA Bulletin W-15020)

⁷ Standards for Internal Control in the Federal Government (GAO-14-704G)



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four types; and each type has its own threshold below which there is no required pre-approval from FEMA for expense reimbursement (see table 2).⁸ Furthermore, FEMA cannot explain, or provide documentation that explains, where these thresholds came from or why they were set at their current levels.

Table 2. Types of SALAEs

SALAE Type*	Description	Specific FEMA Approval Required
1 - Expert	Expense (Categories: Engineer, Surveyor, CPA, Salvor, etc.) incurred to adjust a specific claim	Expenses exceeding \$2,500 in the aggregate
2 - Adjuster	Expense, in excess of the applicable Adjuster Fee Schedule, incurred to establish coverage on a specific claim, or to otherwise facilitate the adjustment	Expenses exceeding the existing Fee Schedule over \$500 in the aggregate
3 - Litigation	Expense incurred to defend a suit within the scope of the Financial Assistance/Subsidy Arrangement brought against the Company on a claim under a WYO policy	Expenses exceeding \$5,000 in the aggregate
4 - Appraisal	Cost of appraisal under the Standard Flood Insurance Policy Appraisal Clause, or cost of examination under oath	Expenses exceeding \$2,500 in the aggregate

*When more than one Type 1 or Type 4 expense is incurred on a claim, the \$2,500 threshold applies to all expenses of that category, e.g., Engineer.

Source: Revisions to Special Allocated Loss Adjustment Expenses (FEMA Bulletin W-10039)

The WYO companies reported 22,158 policies with flood events and associated SALAE payments occurring between October 1, 2012, and December 31, 2014. The SALAE expenses for these policies totaled \$61.3 million through December 31, 2014. To determine FEMA's oversight of these SALAE expenses, we reviewed 269 of these policies, which averaged \$2,296 in total SALAE expenses per policy. The results of our review identified issues with expert, adjuster, and litigation expense submissions. However, no issues were found with the appraisal expense within our sample.

Expert Expenses

We identified expert expenses WYO companies distributed below approval amounts and expert expenses that lacked adequate documentation. We also found there was no formal policy regulating the hiring of experts. FEMA guidance requires approval of only expenses more than \$2,500. Coincidentally, a vast majority of expert expenses fall slightly below that limit; therefore, those expert expenses are not reviewed — which may appear to circumvent the approval process (figure 1 displays the distribution of expert expenses).

When a WYO company submits an expert expense, or an aggregate of those expenses, for more than the \$2,500 threshold, it must follow specific

⁸ Since March 2015, FEMA requires WYO companies to request approval from FEMA prior to reimbursement of all SALAE Type 1 expenses.

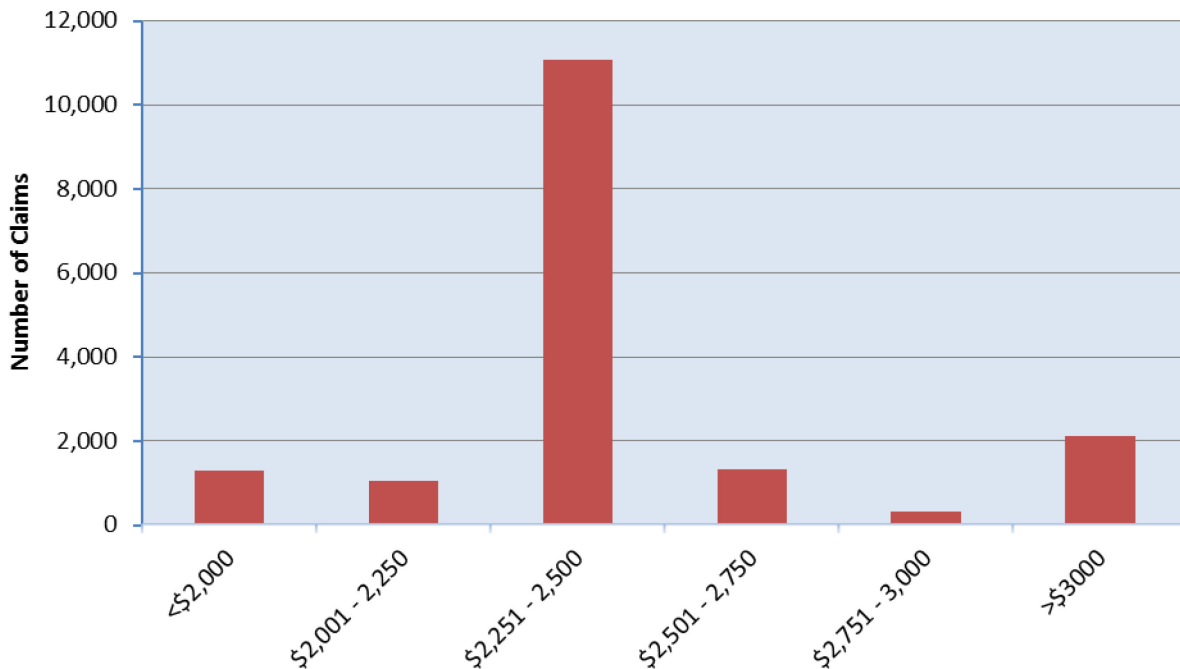


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requirements as indicated in the guidelines to obtain FEMA's approval. This submission may take longer to process, as more information is required before approval is granted, which may account for the high volume of expert expenses that fall just below \$2,500.

Figure 1: Distribution of Expert Expenses by Claim between October 1, 2012, and December 31, 2014



Source: OIG analysis

We reviewed 182 policies with expert expenses. Of these policies, 91percent of the expert expenses sampled (166 policies) were not adequately supported. For example, many expert invoices charged flat fees encompassing the work completed. These invoices lacked a detailed billing of hours worked, receipts for travel expenses, and other miscellaneous expenses. Without detailed invoices and receipts, FEMA cannot be certain that expert expenses are reasonable.

Additionally, FEMA did not have a formal policy that regulated the hiring of engineers, surveyors, CPAs, salvors, or other experts that may be used by the WYO companies. FEMA regulations⁹ require WYO companies to follow their customary business practices in carrying out their WYO functions. FEMA regulations¹⁰ also require the WYO company to comply with written standards, procedures, and guidance issued by FEMA. A formal policy would ensure that the WYO companies hire experts that meet FEMA's standards.

⁹ 44 Code of Federal Regulations Part 62, *Sale of Insurance and Adjustment of Claims*, Subpart C, *Write-Your-Own (WYO) Companies*

¹⁰ 44 Code of Federal Regulations Part 62, Appendix A, *Federal Emergency Management Agency, Federal Insurance Administration, Financial Assistance/Subsidy Arrangement*



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During our review of 190 engineering reports within our sample, we noted that the engineer of record for 6 percent of the reports (12 engineering reports) was not licensed in the state when the engineer or their representative inspected the insured's property. Furthermore, 35 percent of the reports reviewed (67 engineering reports) were missing either a signature, seal, or date. In May 2014, FEMA provided the WYO community a slide presentation emphasizing FEMA's preference for inspections by state-licensed professional engineers and engineering reports that are signed and include either the engineer's license number or seal. On June 1, 2015, FEMA issued formal guidance stating that if an engineer service is required, the WYO company should ensure the action is carried out responsibly by a state-accredited business with a qualified state-licensed professional.¹¹ This was further clarified in a June 2015 email when FEMA notified WYO companies that to receive reimbursement, they must provide documentation that the engineer has an active license or certification in the state where the property is located. Although FEMA issued formal guidance for engineering services during the course of this audit, FEMA still does not have guidance that addresses the hiring of surveyors, CPAs, salvors, or other experts that may be used to adjust a specific claim.

We identified engineering reports prepared by engineers who were not licensed in the state when the insured's property was inspected.

Adjuster Fees

FEMA's guidance on how to calculate supplemental adjuster fees (Type-2 SALAEs) is not specific and requires additional explanation. WYO companies had multiple interpretations on how to calculate these fees.

The guidance explains, in part, that supplemental adjuster fees are:

For losses that require reopening and reassignment of the same or a different adjuster, the additional fee for the supplemental claim will be the larger of: the CWOP [Closed Without Payment] fee; or the difference between the fee determined by the entry value when the claim was initially closed and the entry value for the entire claim after the supplemental claim is concluded.

For us to gain an understanding of the supplemental adjuster fees calculations, a FEMA official provided us with a calculation method (see appendix B).

Using this method, we found three WYO companies in our sample that did not report any supplemental adjuster fees; however, our review found that they did in fact incur those fees. Another WYO company delayed reporting supplemental

¹¹ NFIP Claim Handling Reminder (FEMA Bulletin W-15025)



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adjuster fees because they did not understand the guidance. In our sample of policies, 97 included supplemental adjuster fees that were reported to FEMA. Of these, 31 percent (30 policies' supplemental adjuster fees) were incorrectly calculated. We also found an additional 42 policies that should have reported supplemental adjuster fees to FEMA. If the WYO companies had correctly calculated the supplemental adjuster fees, 139 policies within our sample would have supplemental adjuster fees reported to FEMA. The lack of specific guidance resulted in a 52 percent error rate of calculating additional adjuster fees, which could result in inaccurate financial reporting.

Litigation Expenses

FEMA allows the WYO companies to decide on their own how they manage litigation time and cost. Although FEMA guidance states that FEMA may refuse to reimburse costs for unreasonable costly legal practices, the guidance neither defines what are reasonable litigation fees and costs, nor does it require regular review of litigation expenses less than \$5,000. Because FEMA is ultimately responsible for reimbursing WYO companies for litigation expenses, the companies have little incentive to keep litigation expenses reasonable. FEMA only monitors litigation expenses more than the \$5,000 limit for expressly prohibited items such as alcohol and duplicate charges.

FEMA allows WYO companies to manage litigation time and cost. There is little incentive for the WYO companies to minimize litigation costs.

Additionally, for litigation expenses, the WYO counsel prepares a Case Plan and Budget that lays out the estimated costs and the intended legal arguments for defending the WYO company and NFIP. While WYO counsels are required to submit a Case Plan and Budget for each case, FEMA guidance does not require its review or approval. For example, one case was estimated to cost \$87,000 to resolve in pretrial motions, despite NFIP policy limits of \$25,000 for this policyholder. Additionally, FEMA is not assigning a FEMA attorney to monitor each case, as required by its WYO counsel guidance, because according to FEMA staff, FEMA's Office of Chief Counsel lacks sufficient resources to assign a FEMA attorney to monitor each WYO case. Without any oversight of litigation, FEMA cannot monitor whether a claim is supported by actions that comply with laws and regulations, or involve issues of insurer/agent negligence.

Claims Appeal Process

FEMA does not have adequate internal controls to provide proper oversight of the appeals process. FEMA has an appeals process as required by the regulations; however, the process is not documented and relies heavily on the WYO companies' participation in the appeals review. Additionally, FEMA did not use the appeals process to help identify improvements that could be made to the WYO program pursuant to Federal Government internal control



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standards.¹² GAO's *Standards for Internal Control in the Federal Government* (GAO-14-704G) state that internal control monitoring assesses the quality of performance over time and promptly resolves the findings. According to a FEMA official, prior to Hurricane Sandy, the number of appeals was relatively low and a formal process for tracking appeals was never established.

The current appeals process allows the policyholder to seek an appeal from FEMA once the WYO company issues its written denial, in whole or in part, of the insured's claim. However, in this process, FEMA either agrees with the WYO company on the denial or returns the claim to the company that originally denied it for reevaluation. Because the WYO company was the original decision authority for the claim, policyholders' concerns may not be fairly considered.

FEMA also does not use the appeals process as a management tool that could improve the WYO program. For example, it is unable to readily identify the number of appeals at any given time and does not maintain details on the outcomes of

FEMA is unable to readily identify the number of appeals at any given time and does not maintain details on the outcomes of appeals.

appeals. As a result, FEMA's management acknowledged that after Superstorm Sandy, FEMA's execution of the administrative appeals process failed to uncover problems with claims adjustments.

Recommendations

Recommendation 1: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, develop and implement procedures that will:

- evaluate the results of the oversight performed as required by the Financial Control Plan; and
- determine the overall effectiveness of the established NFIP internal controls.

Recommendation 2: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, develop and implement procedures that will require regular monitoring of SALAE expenses below established thresholds.

Recommendation 3: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, develop formal policies that clearly state FEMA's expectations for all experts hired to perform work under the NFIP.

¹² *Standards for Internal Control in the Federal Government* (GAO-14-704G). The Federal Managers' Financial Integrity Act requires executive branch agencies to establish internal control in accordance with these standards.



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Recommendation 4: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, develop formal instructions for the WYO companies that clearly explain how to calculate supplemental adjuster fees (SALAE Type-2).

Recommendation 5: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, update current guidance so that it will require FEMA to review and approve all Case Plans and Budgets prior to the start of active representation by WYO legal counsel.

Recommendation 6: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, assess resources to better follow current WYO counsel guidance and assign a FEMA attorney to monitor each case.

Recommendation 7: We recommend that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration, properly document existing procedures for the claims appeal process and update the procedures to ensure that:

- policyholders' concerns raised during their appeal are fairly considered;
- FEMA can readily identify the number of appeals and their status or outcome; and
- FEMA is analyzing the outcomes of the appeals to help uncover and prevent problems with the claims adjustment.

Management Comments and OIG Analysis

FEMA concurs with all of the recommendations. A copy of FEMA's response in its entirety is included in appendix A. FEMA also provided technical comments and suggested revisions to our report in a separate document. We reviewed the technical comments and made changes in the report when appropriate. A summary of FEMA's response and our analysis follows.

FEMA's Comments to Recommendation #1: Concur. FEMA's Federal Insurance and Mitigation Administration will evaluate the Financial Control Plan review process and make recommendations on the data to improve WYO company oversight. Estimated Completion Date (ECD): December 30, 2016.

OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until we have reviewed the procedures implemented to evaluate the Financial Control Plan review process

FEMA's Comments to Recommendation #2: Concur. FEMA's Federal Insurance and Mitigation Administration will develop procedures to monitor SALAEs below the appropriate thresholds. ECD: December 30, 2016.



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OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until we have reviewed the procedures developed to monitor SALAEs below established thresholds.

FEMA's Comments to Recommendation #3: Concur. FEMA will develop guidance for all experts hired to perform work under the National Flood Insurance Program (NFIP). ECD: December 30, 2016.

OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until we have reviewed the new guidance developed for experts that work under the NFIP.

FEMA's Comments to Recommendation #4: Concur. FEMA's Federal Insurance and Mitigation Administration will develop guidance for calculating SALAE Type-2 fees. ECD: December 30, 2016.

OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until we have reviewed the guidance developed for calculating SALEA Type-2 fees.

FEMA's Comments to Recommendation #5: Concur. FEMA will develop guidance to begin reviewing and approving Case Plans and Budgets. ECD: December 30, 2016.

OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until we have reviewed FEMA's updated guidance to require FEMA to review and approve all Case Plans and Budgets prior to the start of active representation by WYO legal counsel.

FEMA's Comments to Recommendation #6: Concur. The NFIP Transformation Task Force will begin implementing this recommendation. FEMA intends to increase its attorney staffing to engage in more robust oversight of WYO litigation and to develop revised guidance. ECD: December 30, 2016.

OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until FEMA provides us evidence that it is properly assigning a FEMA attorney to monitor each case.

FEMA's Comments to Recommendation #7: Concur. The NFIP Transformation Task Force began implementing this recommendation in 2015. On February 2, 2016, FEMA launched a new Appeals Branch comprised of



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insurance specialists, program analysts, and staff attorneys, with a goal of resolving any policy disputes on administrative appeal. This new branch intends to institute new processes that should mutually benefit the policyholders in order to provide them with an opportunity to explain and confirm the issue(s) raised on appeal. ECD: December 30, 2016.

OIG Analysis of FEMA's Comments: FEMA's corrective action is responsive to the recommendation. The recommendation will remain open and resolved until we have reviewed procedures put in place to ensure that the policyholders' concerns are fairly considered, appeals are properly tracked, and feedback is provided back to the appropriate branch.

Objective, Scope, and Methodology

The Department of Homeland Security Office of Inspector General was established by the *Homeland Security Act of 2002* (Public Law 107-296) by amendment to the *Inspector General Act of 1978*.

In response to a request from FEMA's Federal Insurance Mitigation Administration Associate Administrator and Congressional interest, we conducted an audit of the Write Your Own (WYO) program under FEMA's National Flood Insurance Program (NFIP). Our audit objective was to determine the adequacy of FEMA's oversight of the WYO program for flood insurance.

To understand the NFIP WYO program and FEMA's oversight role of the program, we obtained and reviewed relevant policies and procedures. These included the *National Flood Insurance Act of 1968*, *Flood Disaster Protection Act of 1973*, Title 44, Subpart B, of the Code of Federal Regulations, *NFIP: The Write Your Own Program Financial Control Plan Requirements and Procedures*, *NFIP Flood Insurance Manual*, *NFIP Guide for Write Your Own Counsel*, and relevant memoranda issued by FEMA clarifying or updating existing NFIP policies and procedures. We also interviewed staff directly responsible for the management, oversight, and execution of the WYO program at both FEMA and selected WYO companies.

We initially planned to review the WYO claims process and all expense reimbursement activities. However, during the initial phase of the audit, we found that multiple layers of review already existed for the claims process and most of the reimbursable WYO expenses except for SALAEs. As a result, we focused most of our review and testing on the SALAE expenses. Our audit did not include FEMA's review of litigation arising from Hurricane Sandy or the Hurricane Sandy review process.

To address FEMA's oversight of SALAEs, we selected a statistical sample of policies with loss between October 1, 2012, and December 31, 2014. Once the sample was determined, we requested and reviewed documentation supporting



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all SALAE expenses incurred for the policies paid between October 1, 2012, and December 31, 2014. The SALAEs reviewed included engineering, litigation, adjuster, and appraisal expenses.

We conducted this performance audit between October 2014 and November 2015 pursuant to the *Inspector General Act of 1978*, as amended, and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based upon our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based upon our audit objectives.

The Office of Audits major contributors to this report are: Sandra John, Director; Devon Houston, Audit Manager; David Kinard, Auditor-In-Charge; Shamika Morris, Auditor; Polin Cohanne, Program Analyst; Richard Joyce, Program Analyst; Vashti Young, Program Analyst; Mohammad Islam, Statistician; Kevin Dolloson, Communications Analyst; Armando Lastra, Independent Referencer.



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Appendix A
FEMA Comments to the Draft Report


U.S. Department of Homeland Security
Washington, DC 20472



FEMA

FEB 04 2016

MEMORANDUM FOR: Mark Bell
Assistant Inspector General for Audits
Office of Inspector General

FROM: David Bibo 
Associate Administrator (Acting)
Office of Policy and Program Analysis

SUBJECT: Response to Draft Report: "FEMA Does Not Provide Adequate Oversight of Its National Flood Insurance Write Your Own Program" (Project No. 14-141-AUD-FEMA)

Thank you for the opportunity to review and comment on this draft report. The Federal Emergency Management Agency (FEMA) appreciates the Department of Homeland Security's Office of Inspector General's (OIG) work in planning and conducting its review and issuing this draft report, which stems from an audit undertaken at FEMA's request to help inform the agency's efforts to improve the National Flood Insurance Program (NFIP).

FEMA is making significant improvements to the NFIP to better serve policyholders who experience loss from flooding. We are overhauling and realigning our entire organization to improve the customer experience. FEMA's vision for reform is a broad effort that emphasizes the principles of trust, predictability, value, and choice for the policyholder. The Federal Insurance and Mitigation Administration (FIMA) is focusing on these improvements, including the need for increased oversight of the program, enhanced education and training, strengthened data gathering and analysis capabilities, and an improved customer experience.

To implement the transformation of the NFIP and deliver a customer-centric reset of the program, the agency has put a new leadership team in place. In a manner that reflects the standards of practice in the financial services industry, FEMA's FIMA now includes assistant administrators for Risk Management, Federal Insurance, Mitigation, and Fund Management. These leaders, along with a 50-person expansion of the base staff will enable the program to deliver on the improved oversight called for in this report and better serve policyholders and flood survivors. FEMA is committed to ensuring we pay every policyholder what they are due under their policy. Flood insurance plays a critical role in assisting survivors on their road to recovery. Like other types of insurance, it does not cover all losses but is the first line of defense against flood.

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FEMA has also taken specific steps to improve its oversight of the NFIP Write Your Own (WYO) Program. We welcome OIG's work to identify areas for improved WYO Program oversight, which will further benefit flood insurance policyholders. It is important to FEMA to ensure that WYO companies properly administer the NFIP.

The Draft Report contains seven recommendations with which FEMA concurs. Specifically, OIG recommended that the Deputy Associate Administrator for the Federal Insurance and Mitigation Administration will:

Recommendation #1: Develop and implement procedures that will:

- evaluate the results of the oversight performed as required by the Financial Control Plan; and
- determine the overall effectiveness of the established NFIP internal controls.

Response: Concur. FEMA's FIMA will evaluate the WYO Financial Control Plan review process and will make recommendations on the data need to improve WYO company oversight.

Estimated Completion Date (ECD): December 30, 2016

Recommendation #2: Develop and implement procedures that will require regular monitoring of SALAE expenses below established thresholds.

Response: Concur. FEMA's FIMA will develop procedures to monitor SALAEs below the appropriate thresholds.

ECD: December 30, 2016

Recommendation #3: Develop formal policies that clearly state FEMA's expectations for all experts hired to perform work under the NFIP.

Response: Concur. FEMA will develop guidance for all experts hired to perform work under the NFIP.

ECD: December 30, 2016

Recommendation #4: Develop formal instructions for the WYO companies that clearly explain how to calculate supplemental adjuster fees (SALAE Type-2).

Response: Concur. FEMA's FIMA will develop guidance for calculating SALAE Type-2 fees.



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ECD: December 30, 2016

Recommendation #5: Update current guidance so that it will require FEMA to review and approve all Case Plans and Budgets prior to the start of active representation by WYO legal counsel.

Response: Concur. FEMA will develop guidance to begin reviewing and approving Case Plans and Budgets.

ECD: December 30, 2016

Recommendation #6: Assess resources to better follow current WYO counsel guidance and assign a FEMA attorney to monitor each case.

Response: Concur. The NFIP Transformation Task Force will begin implementing this recommendation. FEMA intends to increase its attorney staffing to engage in more robust oversight of WYO litigation and to develop revised guidance.

ECD: December 30, 2016

Recommendation #7: Properly document existing procedures for the claims appeal process and update the procedures to ensure that:

- policyholders' concerns raised during their appeal are fairly considered;
- FEMA can readily identify the number of appeals and their status or outcome; and
- FEMA is analyzing the outcomes of the appeals to help uncover and prevent problems with the claims adjustment.

Response: Concur. The NFIP Transformation Task Force began implementing this recommendation in 2015. On February 2, 2016, FEMA launched a new Appeals Branch comprised of insurance specialists, program analysts, and staff attorneys, with a goal of resolving any policy disputes on administrative appeal. This new branch intends to institute new processes that should mutually benefit the policyholders in order to provide them with an opportunity to explain and confirm the issue(s) raised on appeal. In addition, FEMA will transition from its current correspondence-based approach to appeals to one focused on delivering a decision memorandum. The Appeals Branch will work with data specialists in order to provide leadership with the information necessary to track the quantity and status of appeals at the aggregate level and to create feedback loops concerning the substance of the appeals to the other branches involved in the administration of the Federal flood insurance program.



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Department of Homeland Security

ECD: December 30, 2016

FEMA appreciates the OIG's insights on ways to improve the NFIP and thank you for the opportunity to review and comment on this draft report. FEMA provided technical comments separately. Please direct any questions regarding this response to Gary McKeon, Director of FEMA's GAO/OIG Audit Liaison Office, at (202) 646-1308. We look forward to working with you in the future.

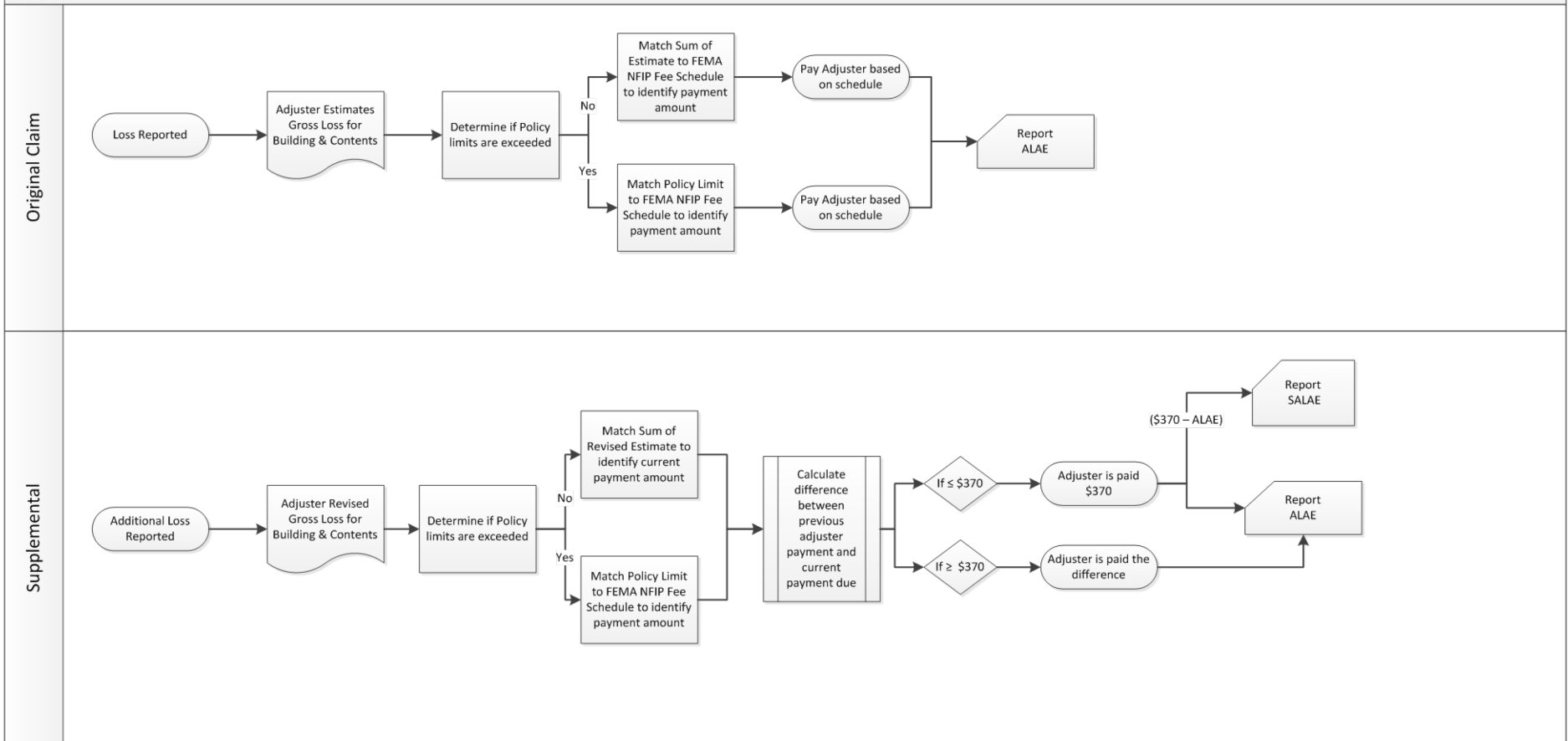


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Appendix B

Methodology to Calculate Supplemental Adjuster Fees (Type 2 SALAEs)



Source: DHS OIG analysis of interview with FEMA



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Appendix C
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