

FEDERAL INSURANCE REFORM AFTER KATRINA

*United States Representative Gene Taylor**

Hurricane Katrina exposed an urgent need for Congress to reform the insurance industry in order to protect property owners and taxpayers after natural disasters.

After Katrina, several insurance companies exploited the weak government oversight of insurance practices to defraud property owners and taxpayers. Companies manipulated insurance adjustments to blame flooding for many losses that should have been covered by the insurers' own windstorm policies.

These practices helped insurers deny thousands of policyholders the coverage for which they had paid high premiums, allowed insurers to shift liability for some wind damage to the National Flood Insurance Program, and saddled federal taxpayers with billions of dollars of repair and rebuilding costs that should have been paid by insurance.

Tens of thousands of homes, businesses, schools, churches, and other buildings near the Mississippi Gulf Coast were destroyed or damaged by the combination of wind and flooding. The Commander Naval Oceanography and Meteorology Command (CNMOC) at the Stennis Space Center has established

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that coastal Mississippi suffered four hours of hurricane force winds before the storm surge.¹ Unfortunately, in many cases, there was not enough physical evidence remaining to determine how much damage had been caused by wind before the surge.

Inland, where there was no flooding, insurance companies paid hundreds of thousands of wind damage claims totaling billions of dollars. Insurance companies paid Katrina wind claims in every county in Mississippi, every parish in Louisiana, most of Alabama, Northwest Florida, and even into Tennessee and Georgia. Yet, on the Mississippi Gulf Coast where winds were strongest, thousands of homeowners were left with uncovered losses because these companies denied their claims for wind damage.

Because it was difficult to prove how much damage was caused by wind and how much was caused by flooding, the central legal question regarding wind/water disputes is which party has the burden to prove the cause of damage. Does the insurance company have to prove how much damage was caused by flooding in order to exclude wind coverage, or does the policyholder have to prove how much damage was caused by wind in order to collect on a wind policy?

State Farm, Allstate, Nationwide, USAA, and several other major insurers took the position that they would only pay for wind damage that was separate from any flooding.² Any damage that they deemed to have been caused by the combination of wind and flooding was to be excluded from their wind coverage.

Less than one week after Katrina, Nationwide issued a document instructing its adjusters that "if loss is caused by both flood and wind there is no coverage."³

¹ COMMANDER NAVAL METEOROLOGY AND OCEANOGRAPHY COMMAND, PRELIMINARY MODEL HINDCAST OF HURRICANE KATRINA STORM SURGE (Nov. 21, 2005), *available at* <http://kern.org/pdf/NRL-Stennis-Katrina.pdf>.

² *See, e.g.*, Memorandum from Prop. and Cas. Claim Consulting Servs. to State Farm Claim Assocs. Handling CAT PL in the Cent. and S. Zones (Sept. 13, 2005), *available at* <http://www.house.gov/genetaylor/SFprotocol.pdf>; *Buete v. Allstate Ins. Co.*, 422 F.Supp. 2d 690 (S.D. Miss. 2006) (mem.) (noting Allstate's position); *NATIONWIDE, WIND VERSUS FLOOD Q & A'S FOR ALABAMA AND MISSISSIPPI 2* (Sept. 4, 2005), *available at* <http://www.house.gov/genetaylor/NationwideQA.pdf>.

³ *NATIONWIDE, WIND VERSUS FLOOD Q & A'S FOR ALABAMA AND MISSISSIPPI 2* (Sept.

Two weeks after Katrina, State Farm issued a memorandum that instructed its adjusters that “[w]here wind acts concurrently with flooding to cause damage to the insured property, coverage for the loss exists only under flood coverage, if available.”⁴

State Farm took the most extreme position among the insurance companies in Mississippi, and insisted that the Anti-Concurrent Causation language in its policies excluded coverage of all wind damage wherever flooding contributed to the loss, regardless of the sequence of wind and flood damage. Thus, under State Farm’s interpretation, wind damage that would have been covered could suddenly become excluded if flooding occurred several hours later.

One week after Katrina, Mississippi Commissioner of Insurance George Dale issued a bulletin advising insurance companies that they had to prove that a loss was caused by flooding in order to deny wind coverage.⁵ State Farm and other companies ignored the bulletin and the Department of Insurance did little to enforce it.

Seven months after Katrina, Commissioner Dale wrote to State Farm reiterating that the company had the burden of proof and further advising that the Anti-Concurrent Causation Provision in State Farm’s policies did not eliminate the company’s obligation to prove the cause of loss and to apportion damage between wind and flooding.⁶

State Farm replied with a letter stating that it would pay for wind damage that it could prove occurred before the surge flooding.⁷ This position still shifted the burden of proof in the

4, 2005), available at <http://www.house.gov/genetaylor/NationwideQA.pdf>.

⁴ Memorandum from Prop. and Cas. Claim Consulting Servs. to State Farm Claim Assocs. Handling CAT PL in the Cent. and S. Zones (Sept. 13, 2005), available at <http://www.house.gov/genetaylor/SFprotocol.pdf>.

⁵ MISS. DEP’T OF INS., BULL. NO. 2005-6 (Sept. 7, 2005).

⁶ Letter from George Dale, Comm’r of Ins., Miss. Dep’t of Ins., to Allen McGlynn, State Farm Fire and Cas. Co. (Mar. 24, 2006), available at <http://www.house.gov/genetaylor/DaleLettertoSF.pdf>.

⁷ Letter from James Burwell, Claims Manager, State Farm Fire and Cas. Co., to Lee Harrell, Deputy Comm’r of Ins., Miss. Dep’t of Ins. (Mar. 31, 2006), available at <http://www.house.gov/genetaylor/DaleLettertoSF.pdf>.

company's favor. Instead of proving how much damage had been caused by flooding in order to deny wind claims, State Farm paid only where it could prove that flooding was not the cause. That position claims all of the benefit of the doubt in State Farm's favor, rather than in the policyholder's favor.

The insurance companies' efforts to shift the burden of proof to policyholders were aided by the National Flood Insurance Program (NFIP). The federal government contracts with insurance companies to sell flood insurance policies that are backed by federal taxpayers. The insurance companies also adjust the flood claims.

Where wind and flooding both have caused damage, an insurance company has a conflict of interest when adjusting both the federal flood claim and its own wind claim. The federal government allows a single adjuster to handle both claims, but the regulation specifies that the company has a fiduciary responsibility to represent federal taxpayers and to provide a proper adjustment of combined wind and water losses.⁸

After Katrina, with so much property destroyed by the combination of wind and flooding, the federal administrators of NFIP should have provided for diligent oversight of the adjustment process to protect the interests of policyholders and taxpayers. Instead, the Director of NFIP issued a policy memorandum that authorized companies to use expedited procedures in areas that FEMA determined had been inundated by storm surge or flooding after levee failures.⁹ Under these expedited procedures, companies were authorized to pay the policy limits of the flood policy without a detailed assessment and in some cases without even visiting the site.¹⁰

NFIP implemented the expedited claims procedure at the insistence of insurance companies that had initiated the concept and drafted the procedures.¹¹ The policy allowed companies to

⁸ 44 C.F.R. § 62.23(f) (2005).

⁹ Memorandum from David I. Maurstad, Acting Dir., Mitigation Div., FEMA, to Write Your Own Principal Coordinators and the NFIP Servicing Agent (Sept. 21, 2005) (on file with author).

¹⁰ *Id.*

¹¹ Rebecca Mowbray, *Memo Called 'Blank Check,'* TIMES PICAYUNE, June 15, 2007,

hand out flood insurance checks from federal taxpayers without proving how much damage had been caused by flooding, without apportioning the amount of wind and flood damage to structures with losses from both perils, and without considering whether some buildings may have been destroyed by wind and wind-driven debris before any flooding occurred.

With neither the Mississippi Department of Insurance nor FEMA requiring insurance companies to prove how much damage was caused by flooding, State Farm and other companies were free to deny and delay claims for wind losses. Meanwhile, companies conspired with adjusting and engineering firms to rig damage assessments.

Internal e-mails between the engineers of Forensic Analysis and Engineering Corporation (FAEC), a State Farm contractor, reveal that State Farm demanded that FAEC not estimate how much damage was caused by wind and how much was caused by flooding, but instead simply determine the “predominant” cause of the damage.¹² After FAEC engineers concluded that wind had been the predominant cause of damage to a few houses, State Farm threatened to fire FAEC and agreed to retain the company only after FAEC agreed to rewrite the reports that had blamed the loss on wind.¹³

At Rimkus Consulting Group, an engineering firm that worked for State Farm, Allstate, and a few other insurance companies, on-site damage assessments that concluded wind was responsible for some of the damage were rewritten by engineers and office managers who had never visited the sites.¹⁴ Several engineers who conducted on-site assessments for Rimkus stated that the company revised their reports to blame all damage on flooding without their knowledge, consent, or consultation.¹⁵

at A-1.

¹² E-mail from Randy Down to Adam Sammis (Oct. 13, 2005, 11:32 CST) (on file with author).

¹³ See Transcripts of Selected Internal E-mails, Forensic Analysis and Engineering Corp. (Oct. 2005), available at <http://www.house.gov/genetaylor/FAECemails.pdf>.

¹⁴ Anita Lee, *Engineer: Reports Altered, Name Forged*, SUN HERALD, Apr. 11, 2006, at A1. For examples of altered engineering reports, see <http://www.house.gov/genetaylor/OIHearing.Docs.htm>.

¹⁵ *Id.*

The *Times Picayune* reported several cases in which insurance companies shifted wind damages to the flood insurance program, including cases involving allegations that NFIP was billed for extensive repairs to homes with no flooding or minimal flooding,¹⁶ cases in which adjusters used much higher estimates for building costs when figuring the amount of the flood claim than when estimating the wind payment for the same house,¹⁷ and a case in which adjusters attached a list of upstairs contents to the flood claim for ground floor flooding instead of to the wind claim for upstairs damage.¹⁸

In the aftermath of Hurricane Katrina, the insurance industry has proven beyond any doubt that the private insurance market is not capable of offering adequate coverage in coastal communities. The insurance and reinsurance industries have a well-developed pattern of exploiting the market conditions after a major catastrophe to simultaneously reduce the risk while hiking up their premiums. The market manipulation and profiteering after Katrina surpassed all previous “hard markets” in the insurance sector.

Insurance companies have blamed Katrina as they have stopped writing new policies and doubled, tripled, or quadrupled premiums on existing policies. They have not confined this price gouging to Mississippi and Louisiana, but have jacked up premiums and reduced coastal risk from the Texas Coast to Long Island and Cape Cod.

Almost every private insurance company has stopped offering new windstorm coverage on the Mississippi Gulf Coast, and some companies cancelled existing policies when they came up for renewal. As a result, more and more property owners have no alternative other than the Mississippi Windstorm Underwriting Association, commonly referred to as the Wind Pool, the state’s insurer of last resort.

¹⁶ Rebecca Mowbray, *Insurers bilked flood program, suit says*, TIMES PICAYUNE, May 31, 2007, at A-1.

¹⁷ Rebecca Mowbray, *Same house. Same repairs. Same insurer. Why different prices?* TIMES PICAYUNE, May 20, 2007, at A-1.

¹⁸ Rebecca Mowbray, *Inflated flood claim turns up at trial*, TIMES PICAYUNE, May 20, 2007, at A-13.

The Wind Pool has had to buy more reinsurance coverage on the global market at exorbitant prices. These reinsurance costs forced the Wind Pool to seek a 398% premium increase on residential policies and 268% on commercial policies. Fortunately, the federal government has allowed the state to use eighty million dollars in federal Katrina assistance to subsidize the Wind Pool for two years.¹⁹ This temporary federal subsidy does not alter the long-term dilemma facing the Wind Pool and the Mississippi Gulf Coast.

Other coastal states also are suffering almost as badly as Mississippi and Louisiana. Insurance companies have dumped half of the policies in Texas coastal counties into the Texas Wind Pool, which is projected to have sixty billion dollars in risk by the end of 2007.²⁰ Insurers have dumped almost fifty billion dollars in coastal liability into North Carolina's wind pool. Forty percent of the policies on Cape Cod have been forced into the Massachusetts FAIR plan, that state's insurer of last resort.²¹ Every county and parish on the Gulf and Atlantic Coasts is undergoing similar insurance market failures.

Congress needs to address this insurance crisis now, before the next disaster.

I am a lead cosponsor of H.R. 1081,²² legislation to repeal the McCarran-Ferguson Act, which exempts the business of insurance from federal anti-trust laws. No one should be above the law. Katrina proved that states are not capable of protecting consumers and taxpayers from unfair business practices by global insurance and reinsurance companies.

When insurance companies say they must cancel policies in New York because global reinsurance premiums tripled as a result of a hurricane in Mississippi, it should be clear that regulation of the insurance industry is far beyond the reach of individ-

¹⁹ MISS. DEV. AUTH., RATEPAYER AND WINDPOOL MITIGATION PROGRAM RECOVERY ACTION PLAN, AMENDMENT 3—MODIFICATION 1 (Feb. 12, 2007).

²⁰ Ryan Myers, *Last resort windstorm policies soar in SE Texas*, BEAUMONT ENTERPRISE, Sept. 2, 2007.

²¹ Sarah Shemkus, *Cape residents vent insurance ire*, CAPE COD TIMES, Sept. 8, 2007.

²² Insurance Industry Competition Act, H.R. 1081, 110th Cong. (2007).

ual states.

My priority insurance reform proposal, the Multiple Peril Insurance Act, has been approved by the House of Representatives as part of H.R. 3121, the Flood Insurance Reform and Modernization Act.²³ I am now working with Senator Thad Cochran of Mississippi, and other supporters, including Senator Chuck Schumer of New York, Senator Mel Martinez of Florida, and Senator Mary Landrieu of Louisiana to build Senate support.

The Multiple Peril Insurance Act, which I introduced in February 2007 as H.R. 920,²⁴ would create an option in the National Flood Insurance Program to offer both wind and flood coverage in a single policy. This would allow coastal residents to buy insurance and know that their hurricane damage would be covered without needing to hire lawyers, engineers, and public adjusters to try to distinguish the wind damage from the flood damage. The bill would require the premiums for the new coverage to be risk-based and actuarially sound so that the program would pay for itself.

This bill is not asking inland taxpayers to subsidize coastal property owners. On the contrary, it is asking that coastal property owners be able to pay premiums for more comprehensive insurance coverage so that taxpayers do not have to provide FEMA trailers, subsidized loans, homeowner repair grants, and special tax deductions after future disasters. Taxpayers everywhere will benefit when more hurricane damage is covered by insurance premiums rather than by inefficient disaster assistance programs.

The Multiple Peril Insurance Act also will stabilize the insurance markets in coastal areas where insurance companies have stopped writing new policies. Insurance companies could return to coastal markets to sell homeowners' insurance covering fire, theft, and liability risks without taking on the hurricane risk that they are avoiding. The agents would receive a commission for selling the federal multiple peril policy and the company

²³ H.R. 3121, 110th Cong. (2007).

²⁴ Multiple Peril Insurance Act, H.R. 920, 110th Cong. (2007).

would be reimbursed for reasonable administrative expenses.

In a recent report that detailed the volatility of the wind-storm insurance market in Gulf states, economist Lloyd Dixon, of the RAND Corporation, explained the benefit of a federal insurance pool to cover hurricanes and other major disasters:

Government is also not subject to the private-sector factors that produce large swings in premiums around expected loss in private insurance markets. Thus, compared with the private sector, government should be able to set insurance prices closer to expected loss for hurricanes and other catastrophic risks, and keep those prices closer to expected loss over time.²⁵

Of course, a federal wind and flood program also would spread the hurricane risk geographically. This would make it much more stable than the current system where each coastal state has its own high-risk pool. Insurance works best when the insured pool can spread the risk. A federal pool spread over all coastal states would not have a high percentage of its properties hit at one time. On the other hand, a single state pool with concentrated risk could have losses to most of its properties after a major hurricane.

The Multiple Peril Insurance Act would offer residential coverage up to \$500,000 for the structure and \$150,000 for the combination of contents and additional living expenses. The bill would offer one million dollars coverage for a nonresidential structure and \$750,000 for the combination of contents and business interruption coverage. These coverage limits should be sufficient to cover most coastal properties. A private insurance market should develop to offer the excess coverage for those homes and businesses that need additional coverage above the federal program's policy limits.

The new wind coverage would be available only in combination with flood coverage, and would only be available in communities that have adopted building codes that are consistent with the windstorm standards of the International Building Codes.

²⁵ LLOYD DIXON, JAMES W. MACDONALD & JULIE ZISSIMOPOULOS, COMMERCIAL WIND INSURANCE IN THE GULF STATES: DEVELOPMENTS SINCE HURRICANE KATRINA AND CHALLENGES MOVING FORWARD 3 (2007).

The program would set premiums according to risk by using the same data available to insurance companies and state wind pools. Once the risk is estimated for a location, the premiums for specific properties would be set by adjusting for construction methods, foundation, wall, and roof types, and other building characteristics.

During House consideration of H.R. 3121,²⁶ I offered an amendment to prohibit insurance companies that participate in the NFIP from using Anti-Concurrent Causation provisions in their own policies to exclude coverage of wind damage simply because flooding also contributed to the damage. This would protect the homeowners who continue to have separate wind and flood policies. My amendment was approved by voice vote without opposition.

The Multiple Peril Insurance Act would not have made it through the House of Representatives without the strong leadership of Speaker of the House Nancy Pelosi. The Speaker has visited the Mississippi Coast three times since Katrina and on two of those occasions she allowed me to arrange town meetings on insurance issues for the visiting Congressional Delegations. Before the Financial Services Committee vote on the bill, the Speaker personally urged the Democrats on the Committee to support it.

The Multiple Peril Insurance Act also received strong support from House Financial Services Committee Chairman Barney Frank, Housing Subcommittee Chairman Maxine Waters, and Oversight and Investigations Subcommittee Chairman Mel Watt. Representative Maxine Waters held three hearings on the insurance concerns addressed by this bill. Representative Mel Watt held two hearings on the handling of Katrina insurance claims. Chairman Frank merged H.R. 920,²⁷ with his flood insurance reform bill, H.R. 1682,²⁸ to create H.R. 3121,²⁹ and managed the bill through the Committee and on the House floor.

The legislation passed the House by a vote of 263-146, with

²⁶ H.R. 3121, 110th Cong. (2007).

²⁷ Multiple Peril Insurance Act, H.R. 920, 110th Cong. (2007).

²⁸ H.R. 1682, 110th Cong. (2007).

²⁹ Flood Insurance Reform and Modernization Act, H.R. 3121, 110th Cong. (2007).

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the support of 218 Democrats and 45 Republicans. From the beginning, the multiple peril bill had broad Democratic support and the support of Republicans from coastal districts, including Representative Bobby Jindal of Louisiana, Representative Walter Jones of North Carolina, Representative Jo Bonner of Alabama, and Representative Jeff Miller of Florida.

Governor Haley Barbour and Senator Trent Lott submitted letters of support for the Multiple Peril Insurance Act to the House Financial Services Committee before the committee acted on the bill. The new optional wind coverage received an important boost when it was endorsed by the National Association of Home Builders in early September. The National Association of Realtors and the American Banking Association also urged Members of Congress to support H.R. 3121.