ISSUE 11

DISASTER RECOVERY TODAY

ADJUSTERS INTERNATIONAL
DISASTER RECOVERY CONSULTING

Know Your Obtain and Maintain Requirements!

A Second Disaster Strikes: Will FEMA Pay Again?

FEMA's Obtain and Maintain Requirements
Section 311 of the Stafford Act requires an applicant to purchase and maintain insurance – where that insurance is reasonably available – as a condition for receiving disaster assistance. FEMA Public Assistance Guide PA 322, pages 94-95.

Responding to and recovering from a disaster are monumental tasks for you and your organization. Those tasks are not over if you have lost or suffered permanent damage to insurable property such as buildings, computers, heavy equipment and vehicles. If FEMA provided grant funds for the repair or replacement of facilities or items that are insurable, your organization is required to **obtain and maintain** (see above) insurance now and for the

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IN THIS ISSUE

In this edition of *Disaster Recovery Today* we take an in-depth look at FEMA's Obtain and Maintain requirements for property insurance coverage and their relationship to an applicant's ability to receive Public Assistance funding.

This extensive piece discusses how lessons from hurricanes Katrina and Rita and the terrorist attacks of 9/11 provide the backdrop for the FEMA requirements.

FEMA's Requirements
Continued

Insurance Purchase Requirements – All Disasters
As a condition for receiving public assistance for a facility, an applicant must obtain and maintain insurance to cover that facility for the hazard that caused the damage. Such coverage must, at a minimum, be in the amount of the estimated eligible project costs for that structure prior to any reduction. If the requirement to purchase insurance is not met, FEMA will not provide assistance for damage sustained in the current disaster. If the applicant does not maintain insurance, FEMA will not provide any assistance for that facility for future disasters. An applicant is exempt from this requirement for:

- Projects where the eligible damage is less than $5,000; or
- Facilities for which, in the determination of the state insurance commissioner, insurance is not reasonably available, adequate and necessary. (This exemption does not apply to facilities insurable under the NFIP [National Flood Insurance Program], where insurance is considered to be "available and reasonable.")

The commitment by the applicant to purchase and maintain insurance must be documented and submitted to FEMA before project approval. FEMA Public Assistance Guide PA 322, pages 97-98.

remaining life of the asset in the amount of the FEMA Public Assistance funding received for the hazard that caused the damage (e.g., flood, wind, terrorism).

Failure to meet this requirement means risking the loss of all Public Assistance funding for that facility or item if it is damaged by the same hazard again in the future. This could pose a serious challenge to your organization's operating budget if your disaster losses are substantial, as was the case for FEMA Public Assistance Program applicants in the California Northridge Earthquake of 1994, the New York City 9/11 disaster in 2001, the Florida hurricanes of 2004 and 2005, the Gulf Coast Katrina and Rita disasters of 2005, and hurricanes Ike and Gustav in 2008.

Not only are you faced with buying new property insurance to meet the obtain and maintain requirements — thereby increasing your insurance premiums now and for the future — you could be faced with a highly volatile insurance market, as was the case in the disasters cited.

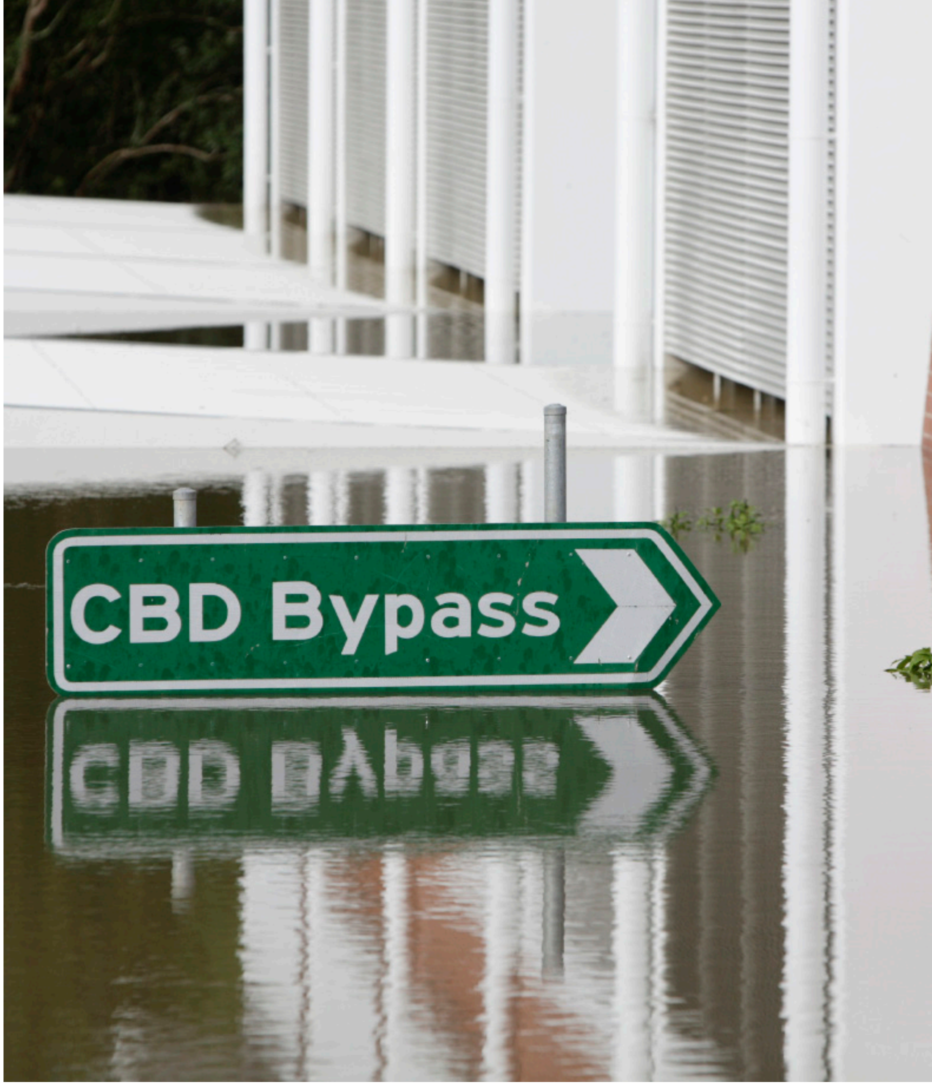
Additional insurance coverage —

- Might not be available to you or available in the levels needed to insure the total amounts of your FEMA project grants;
- Might be available, but priced at far higher premiums than were the case pre-disaster;
- Might be accompanied by substantial increases in deductibles.

It is very important to understand FEMA's insurance requirements and the potential liabilities they pose. The focus of this issue of *Disaster Recovery Today* is to provide you with an understanding of those requirements, along with FEMA's process for dealing with insurance. What's more, we will provide strategies you can use to ensure your recovery.

LESSONS FROM KATRINA

While the Katrina and Rita disasters in 2005 far exceeded the scope and damages of the 9/11 event, the effects on Public Assistance applicants and the insurance marketplace were all too similar. As applicants slowly moved from response to recovery, FEMA's obtain and maintain requirements became of paramount concern across the Gulf Coast region.



- Beyond the NFIP (National Flood Insurance Program) insurance, **property coverage was either not available or available in the amounts needed** by applicants to meet obtain and maintain requirements. *For example, one entity could obtain only 20 percent of the coverage needed and then only from Lloyd's of London.*

- The cost of premiums for new or renewal policies, needed to comply with obtain and maintain requirements, increased **three to 10 times**. *For one policyholder, pre-Katrina insurance coverage had been 3.52 percent or $35,200 per $1 million of coverage. Post-Katrina, the cost escalated to $125,000 per $1 million — a 284-percent increase — with less coverage and higher deductibles!*

- **Deductibles** rose from pre-Katrina ranges of 2-5 percent to 5, 10 or even 15 percent, thus transferring greater levels of risk to the applicants and their budgets.

- **Mandatory NFIP reductions** ran to tens of millions of dollars for applicants where substantial damage occurred to their facilities in SFHAs (Special Flood Hazard Areas) — and the applicants had not purchased NFIP insurance for their buildings and contents prior to Katrina. The mandatory reduction penalty for each facility was often at the NFIP maximum insurance amount of $500,000 for the building and $500,000 for contents — a "hit" of $1 million per facility that seriously reduced or zeroed out the applicants' Public Assistance grants before the first dollar of FEMA assistance reached them.

- **Anticipated wind and flood insurance assessments** by FEMA also reduced applicants' access to Public Assistance funding. Applicants are required to

"Failure to meet this requirement means risking the loss of all Public Assistance funding for that facility or item if it is damaged by the same hazard again in the future."

provide copies of property insurance policies to FEMA at the beginning of the project worksheet preparation process. FEMA insurance staff then make determinations of "anticipated" proceeds from insurance that the applicant is likely to receive.

These anticipated insurance proceeds are potential duplications of benefits that FEMA cannot fund under the law. This factor meant that anticipated insurance funds were applied to each project, reducing the amount of the grant award — in some cases to the level of a small project ($55,500 threshold in 2005) or zero. For one applicant this translated into $50 million in reductions for needed permanent projects before actual dollars were released for the rebuilding or replacement of the facilities, seriously inhibiting and delaying the applicant's ability to recover.

The insurance lessons of the Katrina disaster are all too clear:

- Catastrophic disaster losses **negatively affect the insurance marketplace for an indeterminate period of time** resulting in problems of availability, the addition of new exclusions, increased deductibles and funds being withheld at the time of an applicant's greatest need.
- **Obtain and maintain compliance** may be impossible for applicants to achieve or at the very least can seriously strain their current and future operating budgets, leading to reductions in public service.
- **FEMA policies and procedures may delay or prevent** Public Assistance grant funds from reaching applicants.
- Failure to comply with the insurance requirements of FEMA's Public Assistance Program may preclude an applicant's critical facilities from receiving funding for any future disasters.

The magnitude of the Katrina disaster may not be known for many years, nor will the final audits and closeouts be completed soon. We do know, however, that FEMA's insurance requirements, particularly as they involve obtain and maintain provisions, will continue to be with us.

LESSONS FROM 9/11

Until the 2005 Katrina disaster, the largest recent FEMA disaster had been the September 11th, 2001 terrorist attacks on the World Trade Center. By February 2002, the insurance implications of catastrophic disasters were given national attention and scrutiny by the testimony of then-New York State Superintendent of Insurance Gregory V. Serio, before the Subcommittee on Oversight and Investigations of the

House of Representatives Committee on Financial Services.

In his testimony, Serio described the market conditions that existed after 9/11:

• "Coverage for acts of terrorism is **no longer available** for the largest commercial risks and its availability in the small and medium-sized markets is spotty and, where available, is offset by **dramatic increases in rates**."

• "This coverage…is now endorsed by terrorism exclusions and…premiums have **dramatically increased**… as **availability** in the traditional admitted market has **declined**."

• "**Governments**, too, are finding it either problematic to secure coverages or afford the premiums that are being charged."

• "**Hospitals** were the first New York business sector to experience significant difficulties in obtaining adequate and affordable property coverage for their facilities post-September 11th." (For example, on renewal, one philanthropy operating several metro hospitals was able to obtain only 20 percent of the coverage limits of its expiring policy, experienced broad terrorism exclusions and a tighter "occurrence" definition in the renewal policy, and faced premiums three times higher from 23 insurers who collectively provided one-fifth of the organization's pre-9/11 coverage.)

• **Real estate developers and trusts** encountered problems in obtaining lending for major projects due to covenants contained in indentures, which required adequate insurance.

• **Even sports teams** had trouble securing terrorism insurance. After 9/11 insurers were "offering significantly less coverage at substantially higher rates to professional sports teams in all venues. The New Jersey Sports and Exposition Authority, which managed Giants Stadium, saw its insurance costs more than triple — to $2.4 million."

Concluding his testimony, Superintendent Serio said, "The insurance industry does not have the capacity to absorb repeated losses such as the one inflicted on September 11th. The catastrophic nature of, and the potential of unlimited losses stemming from, this exposure make it impossible for the industry to bear the risk. Secondly, insurance rates are assumptions of loss frequency and severity. The frequency and severity of terrorism losses are impossible to predict… making it nearly impossible for the industry to develop an appropriate premium."

In summary, 9/11 demonstrated in dramatic fashion the volatility of the property insurance marketplace, the expansion of policy exclusions, the crippling lack of availability of adequate property insurance coverage and costly increases in premiums.

Whether a disaster is man-made or natural, obtain and maintain requirements continue to pose major hurdles for the operating budgets and risk management decisions of Public Assistance Program applicants.

STRATEGIES FOR YOUR RECOVERY

Following these strategies will help you and your organization better prepare for and handle insurance issues when a disaster occurs.

Prior to a Disaster —

- Update your property lists regularly and include the following information if possible:
  - — Address and GPS locations.
  - — NFIP FIRM (Flood Insurance Rate Map) designation and location.
  - — Appraisals and/or elevation certificates if available.
  - — Photos of facilities (digital preferred).
  - — Maintenance records and other property information you deem to be important.

- Review your insurance coverage at least annually and make certain that insurance policy schedules are coordinated with your property lists.

- Consider purchasing NFIP flood insurance for properties in flood zones to avoid possible mandatory reductions in future disaster events.

- Maintain disaster files with project worksheets, along with insurance information to prove that projects were completed and insured adequately.

- Keep copies of insurance and property information in safe, off-site locations.

If a Disaster Occurs —

- Prepare copies of your insurance policies for transmittal to FEMA. Prepare a transmittal form and ask the Project Officer (PO) or Public Assistance Coordinator (PAC) to sign for their receipt.

  [Tip: Make a duplicate set because records are often misplaced or not transmitted to new FEMA staff who rotate in to become part of your team.]

- Contact your NFIP flood insurance carrier and begin working immediately on developing your claim. Your NFIP insurance payments will require effort and time to settle, but could move needed funds to you faster than your property insurance settlement.

- Contact your property insurance company to alert them that you have suffered insurable damage.

- Begin developing and documenting your list of damaged facilities and losses — supported by photographs, inventories and facilities/equipment lists, and records of force account equipment and labor use. FEMA will require this shortly after their team arrives on the scene.

- Ensure that your state's insurance commissioner and emergency management office are aware of the state's right to waive obtain and maintain requirements.

Louisiana Commissioner's Actions Will Promote Recovery

In February 2007, staff from Adjusters International and their strategic partner, SIGMA Consulting of New Orleans, met with James J. Donelon, Commissioner of Insurance for the State of Louisiana, his staff, and representatives of the Governor's Office of Homeland Security and Emergency Preparedness, to present the concept of an insurance waiver for the obtain and maintain requirements of the Stafford Act (42 United States Code §5154(a)(2)). Several months of research and discussions resulted from this first meeting and culminated in Commissioner Donelon issuing an Insurance Commissioner's certification letter addressed to President Bush (see page 8).

Unlike previous attempts by state insurance commissioners to completely waive the obtain and maintain requirements for specific projects of individual applicants, Commissioner Donelon's waiver recognized the magnitude of the Katrina-Rita disasters for Louisiana and established a unique approach: Louisiana's certification process focuses on certifying the applicant's insurance program, not just specific projects.

The application and certification process takes into account the availability of property insurance, increases in premium costs, deductibles, the type of entity, and budget of the entity.

"Whether a disaster is man-made or natural, obtain and maintain requirements continue to pose major hurdles for the operating budgets and risk management decisions of Public Assistance Program applicants."

The waiver application requires the applicant to:

1. Procure NFIP flood insurance for building and contents for all flood-damaged facilities;

2. Allocate a reasonable portion of the applicant's operating budget [percentage of operating budget as outlined by the commissioner's letter] to purchase property insurance for facilities that are the subject of Public Assistance grants;

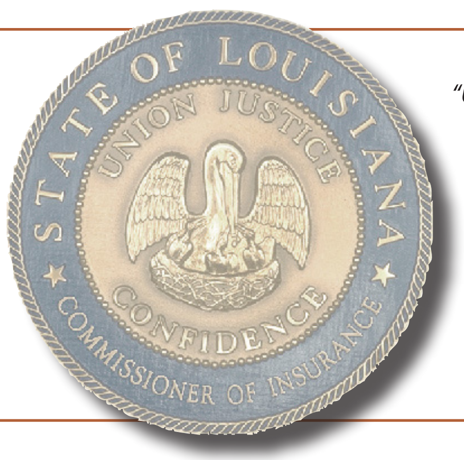
3. Procure property coverage, including wind and other perils (exclusive of flood), up to the replacement cost if budget allows;

4. Attempt to negotiate deductibles that are 10 percent or less, but that do not exceed 15 percent;

5. Separate business interruption and liability insurance from these considerations unless it can be shown that this expense is being incurred to meet FEMA Public Assistance Program grant requirements;

6. Provide documentation of compliance with the above criteria.

The actions of Louisiana's Commissioner of Insurance afforded by the Stafford Act and the McCarran-Ferguson Act [15 U.S.C. §20] are a vital link in the state's recovery. Adjusters International and SIGMA Consulting are proud to have participated in this effort to bring insurance relief to Katrina applicants.



"Under the authority granted to me by the Stafford Act as the Commissioner of Insurance for the State of Louisiana, I hereby certify that commercial insurance coverage for the perils of flood and wind is not reasonably available to Applicants in order for Applicants to procure property insurance coverage for the full amount of their eligible disaster assistance to be received under the Stafford Act for damages sustained as a result of Hurricanes Katrina and Rita."

James J. Donelon, *Louisiana Commissioner of Insurance*

Letter to President George W. Bush, August 10, 2007

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