

FEDERAL EMERGENCY MANAGEMENT AGENCY

44 CFR Part 62

RIN 3067-AC62

National Flood Insurance Program; Assistance to Private Sector Property Insurers

AGENCY: Federal Insurance
Administration (FEMA).

ACTION: Final rule.

SUMMARY: This rule amends the National Flood Insurance Program (NFIP) regulations establishing the Financial Assistance/Subsidy Arrangement. This Arrangement may be entered into by and between the Administrator and private sector insurers under the Write Your Own (WYO) program. The amendments to the Arrangement: reduce the range between the minimum and maximum amount of premium income a company may retain as an expense allowance as a result of its marketing performance; restructure the Arrangement so that under no circumstance would a company have to return any portion of the expense allowance; reformat the Arrangement to make it easier to read; standardize references throughout the document, and add details to clarify responsibilities of private sector insurers under the Arrangement with regard to reporting requirements, litigation, and "errors and omissions."

EFFECTIVE DATE: October 1, 1997.

FOR FURTHER INFORMATION CONTACT: Edward T. Pasterick, Federal Emergency Management Agency, Federal Insurance Administration, 500 C Street SW., Washington, DC 20472, 202-646-3443.

SUPPLEMENTARY INFORMATION: On May 1, 1997, FEMA published in the **Federal Register**, 62 FR 23736, a proposed rule to amend the NFIP regulations establishing the Financial Assistance/Subsidy Arrangement that may be entered into by and between the Administrator and private sector insurers under the Write Your Own (WYO) program. FEMA received five sets of comments on the proposed rule.

One WYO company considered the reference to WYO companies as insurers to be "ambiguous." The commenter added that this perceived ambiguity potentially transfers risk to the WYO companies. As FEMA responded last year on this issue, the Arrangement is a financial assistance/subsidy agreement that FEMA shall honor with its industry partners as it has for the past fourteen years—within the scope of Congressional authorization and the

safeguards built into the enabling legislation to facilitate continued operation of the NFIP. Those safeguards include: 1. the agency's borrowing authority for the National Flood Insurance Fund which operates independently of fiscal year authorization, and 2. financial assistance of the Federal Government for the WYO companies as spelled out in the Arrangement. In addition to those safeguards and the Federal financial backing of the private insurers participating in the Arrangement, the *quid pro quo* of sound mitigation in return for public backing of flood insurance is at the very foundation of the NFIP. It was the express wish of Congress that in time the private sector would assume more of a share of the risk, as the NFIP's mitigation programs and activities reduce the exposure of properties to flood loss. In FEMA's view, the references in Article I to the evolution of risk-sharing by participating companies are appropriate in the light of both the Congressional intent for the program and FEMA's continuing success in partnership with State and local governments in achieving more effective flood hazard mitigation. To place these concerns in clearer perspective, FEMA and the companies understand that participation on the part of private insurers in the program is voluntary, and, as with any risk venture, the insurer will weigh the advantages of the WYO program against any uncertainties—regardless of how remote—before making an informed decision to participate.

Three companies expressed concern that the marketing guidelines are not in the Arrangement and are only referred to in Article II. G. One of the commenters believed that, since companies do not know until the Arrangement is published as a final rule what the marketing guidelines are, this absence could affect a company's decision to enter into the Arrangement. In a related concern about Article III, the same commenter said "without knowing the 'marketing goal' for 1998, it's impossible to know whether we can earn more than the minimum expense allowance. Such uncertainty is patently unfair, a violation of the insurer's due process and not suitable for either party to the Arrangement."

FEMA acknowledges the concern but does not agree with the commenter's conclusions concerning due process or fairness. Simultaneous with the publication of this rule, marketing goals will be distributed by FEMA. Hence, a company will have approximately two months to make an informed decision

whether it wishes to sign the Arrangement for the coming year. Historically, providing marketing guidelines after publication of the final Arrangement for the coming year has given companies enough time and has not proved to be an obstacle for participation in the WYO program. Companies for this year, as in the past, will continue to have complete information on marketing guidelines—the basis for the amount of premium income a company may retain—before being asked to sign the Arrangement. FEMA does not foresee any problems developing on this score.

Another company that expressed concerns about the program's marketing goals recommended that a company's marketing efforts and expenditures should be analyzed and considered by FIA in addition to the company's actual growth results as the basis for determining the percentage of premium income to be retained by the company. FEMA acknowledges that in order to achieve marketing goals a company will have to invest its own resources; however, unlike accomplishments, which can be measured, there is no way to measure effort or activity per se. FEMA believes however that the increase in the expense allowance that a company may retain under this year's Arrangement takes into account any increased efforts that companies will make to market flood insurance. Hence, the Arrangement for this year will continue to tie a WYO company's retention of premium income to performance, i.e., actual growth in flood insurance policies. FEMA will however review any relevant data during the 1997-8 Arrangement year that would warrant further adjustment to the percentages of retained premium income for subsequent Arrangements.

The third company commenting on the marketing goals recommended that under "Article III—Loss Costs, Expenses, Expense Reimbursement, and Premium Refunds" of the Arrangement, the maximum expense allowance a company may retain be increased from 32.9 percent to 33.6 percent. This company claimed that "having a maximum recovery of 32.9 percent is just too low to justify the expense involved achieving the necessary new policy growth targets" and recommended 33.6 percent as the maximum expense allowance a company may retain based on its performance.

FEMA disagrees with this recommendation. The minimum level of premium income a company may retain for the 1997-8 Arrangement year has been increased from 30.6 percent to 31.6

percent while the maximum earning of 32.9 percent of retained premium also represents a substantial increase. It should be emphasized that under former Arrangements, the maximum a company in the WYO program could earn was equivalent to the average expense ratios for "Other Acq.," "General Exp.," and "Taxes," as published in the latest available "Best's" Aggregates and Averages: Property Casualty Insurance Underwriting—by Lines for Fire, Allied Lines, Farmowners Multiple Peril, Homeowners Multiple Peril Combined. The "Best's" average for this year is 31.9 percent. Hence, the maximum earning for companies participating in the WYO program for the 1997–8 Arrangement year—32.9 percent—is one percent above the "Best's" average—the former maximum WYO companies could earn under the NFIP.

FEMA believes therefore that the increases in the percentage of premium a WYO company may retain in connection with its performance proposed for this year's Arrangement are appropriate and have been retained in the final rule. FEMA plans to revisit the expense allowance percentages vis-à-vis performance prior to the Arrangement Year for 1998–9.

The issue of surcharges on flood insurance premium and guaranty fund assessments was raised in several comments. A change was made in last year's Arrangement regarding surcharges on flood insurance premium and guaranty fund assessments. That provision has been retained. FIA will review the issue during the next Arrangement year and propose any further adjustments regarding such surcharges during the rulemaking process in connection with the 1998–9 Arrangement.

One commenter objected that the percentage (3.3 percent) paid to WYO companies for unallocated loss adjustment expenses is inadequate—one that has not changed since the program's inception. As FEMA indicated in the publication of last year's Arrangement, "the matter * * * warrants review, and any modification to the loss adjustment expense will be considered at the end of the current Arrangement year." FEMA has been reviewing this matter, and we expect to have a final determination on this issue before the 1998–9 Arrangement year. The 3.3 percent for unallocated loss adjustment expense has been retained in this year's Arrangement until our review is complete.

One commenter recommended that the fee schedule be restored as Exhibit A to the Arrangement. The fee schedule was removed last year from the

Arrangement in the interest of flexibility and expedition. Since any change to the fee schedule will be closely coordinated with participating WYO companies, the decision to remove the fee schedule from last year's Arrangement will be followed this year as well.

One commenter cited an inconsistency in "Article II.B. Time Standards" in which the standards are referred to as both "guidance" and "requirements." We agree that there is an inconsistency and have deleted the reference to "guidance" from "Article II. Time Standards."

Two companies asked whether the impact of claims for loss under Increased Cost of Compliance (ICC) coverage on company's adhering to time standards has been taken into consideration. It should be noted that the claim under ICC coverage is a separate claim from the claim for direct physical loss from flood under the policy and is usually filed after the insured has done some preliminary coordination with local officials and contractors. The "clock" for ICC claims will not begin until the loss is reported by the insured. Also, a WYO company will not be penalized because of any inaction or delays by the insured or the local government. However, since ICC is a new product, FEMA will evaluate the program's experience with ICC claims during the 1997–8 Arrangement year and propose any appropriate changes to the time standards before the next Arrangement year.

One commenter expressed concern that the reference to "litigation and/or claim" in Article III.D.3. is confusing and should be changed to "notice of claim in litigation" or "claim in litigation." FEMA agrees and has changed the phrase in the last sentence of the first paragraph of Article III.D.3 to read, "claim in litigation."

Another company expressed concern over the requirement for the company to notify both the FIA Administrator and FEMA's OGC of claims in litigation. The company recommends that the reporting requirements of claims in litigation be limited to the FIA Administrator. The reason for the Arrangement's dual reporting requirement is that the notification to the FIA Administrator is for the purpose of prompt payment of bills to the company assuming that all required information has been submitted. The reason for a separate notification of FEMA's Office of General Counsel, however, is to ensure that FEMA's Office of General Counsel will be involved in the review of any litigation as soon as possible should assistance be requested or needed by the company. FEMA agrees that it would be

more appropriate for the company to submit notice of litigation in duplicate to the FIA Administrator who will then ensure that the Office of General Counsel receive its copy. The language of the second paragraph of Article III. D. 3 has been changed to read, "Prompt notice, in duplicate, of any such claim for damages within the scope of this section (D) shall be sent to the Administrator along with a copy of any material pertinent to the claim for damages. The Administrator shall furnish one copy of all such claims to the Associate General Counsel for Litigation, FEMA OGC, 500 C St. SW, Washington, DC 20472. Following the initial notice of claims in litigation, the company must submit all pertinent material and billing documentation as it becomes available. Within 60 days of the receipt of a claim in litigation by the Company, the company must submit an initial case analysis and legal fee estimate. Failure to meet these notice requirements may result in the Administrator's decision not to reimburse expenses for which FIA and the FEMA OGC have not been notified in a timely manner."

This change does not prevent a company, if it so chooses, in the interest of expedition, to follow the procedure as proposed in the May 1, 1997 proposed rule and submit notices of claims in litigation simultaneously to both the FIA Administrator as well as the FEMA's Office of General Counsel.

The same company also claimed that revised language in "Article IX—Errors and Omissions" could be construed "as an ambiguity allowing for a challenge to the doctrine of federal preemption for the National Flood Insurance Program." The following language was cited by the company as the cause for ambiguity and concern. "In the event that steps are not taken to rectify the situation and such action leads to claims against the company, the NFIP, or other related entities, the responsible parties shall bear all liability attached to that delay, error, or omission to the extent permissible by law." This change to the text does not affect the policy regarding errors and omissions nor will it affect the doctrine of Federal preemption to the extent Federal preemption would be applied to a particular issue. The change clarifies that a party will not be held responsible for inadvertent errors and omissions until those errors became known to that party and are ignored and that party or parties do not take steps to rectify the situation. Furthermore, the party at fault will bear liability only to the extent permissible by law.

In addition to the comments submitted by WYO companies, one commenter asked three specific questions about the WYO Arrangement. The correspondent asked whether the 32.6 percent expense allowance includes reimbursement for insurers' loss adjustment expenses. Unallocated loss adjustment expenses are not included in the 32.6 percent expense allowance and are in addition to that expense allowance. The same correspondent asked if there is a separate provision to reimburse for loss adjustment expenses. There is such a provision at Article III. C, titled "Loss Adjustment Expenses." For unallocated loss adjustment expenses, the fee is 3.3 percent. For unallocated loss adjustment expenses, there is a separate fee schedule which is distributed separately to the private companies participating in the WYO program. Those not participating in the WYO program may receive a copy of the fee schedule for allocated loss adjustments upon written request to the FIA Administrator, 500 C Street SW., Washington, DC 20472.

The FIA received two inquiries regarding the language of Article III—Loss, Costs, Expenses, Expense Reimbursement, and Premium Refunds.

One Write Your Own Company requested clarification regarding the determination by FEMA under Article III, D., 4. that a case in litigation is "grounded in actions by the company that are significantly outside the scope of this Arrangement." Article III D. 4. of the Arrangement provides that such a determination means that "any award or judgement for damages arising out of such actions will not be recognized under Article III of this arrangement as a reimbursable loss cost expense reimbursement."

Any determination that a case in litigation is "grounded in actions by the company that are significantly outside the scope of this Arrangement" would be made on a case-by-case basis based on sufficient information to make a reasonable determination and would also involve an examination of typical business practices in the insurance industry. What is considered sufficient information and typical business practices will depend on the case in question.

Another Write Your Own Company requested a "time standard guideline" for FEMA to make this determination. FEMA is committed to make such a determination as promptly as possible after receipt of sufficient information to make an informed decision.

Finally, in the proposed rule, the "Effective Date" was incorrectly listed as October 1, 1996. The "Effective Date"

in the final rule has been corrected to read October 1, 1997.

National Environmental Policy Act

This rule is categorically excluded from the requirements of 44 CFR Part 10, Environmental Consideration. No environmental assessment has been prepared.

Executive Order 12898, Environmental Justice

The socioeconomic conditions to this rule were reviewed and a finding was made that no disproportionately high and adverse effect on minority or low income populations would result from this final rule.

Executive Order 12866, Regulatory Planning and Review

This rule is not a significant regulatory action within the meaning of sec. 2(f) of E.O. 12866 of September 30, 1993, 58 FR 51735, and has not been reviewed by the Office of Management and Budget. Nevertheless, this final rule adheres to the regulatory principles set forth in E.O. 12866.

Paperwork Reduction Act

This rule does not contain a collection of information and is therefore not subject to the provisions of the Paperwork Reduction Act.

Executive Order 12612, Federalism

This rule involves no policies that have federalism implications under Executive Order 12612, Federalism, dated October 26, 1987.

Executive Order 12778, Civil Justice Reform

This rule meets the applicable standards of section 2(b)(2) of Executive Order 12778.

List of Subjects in 44 CFR Part 62

Claims, Flood insurance.

Accordingly, 44 CFR part 62 is amended as follows:

PART 62—SALE OF INSURANCE AND ADJUSTMENT OF CLAIMS

The authority citation for Part 62 continues to read as follows:

Authority: 42 U.S.C. 4001 *et seq.*; Reorganization Plan No. 3 of 1978; 43 FR 41943, 3 CFR, 1978 Comp., p. 329; E.O. 12127 of Mar. 31, 1979, 44 FR 19367, 3 CFR, 1979 Comp., p. 376.

2. Appendix A of part 62 is revised to read as follows:

Appendix A to Part 62—Federal Emergency Management Agency, Federal Insurance Administration, Financial Assistance/Subsidy Arrangement

Purpose: To assist the company in underwriting flood insurance using the Standard Flood Insurance Policy.

Accounting Data: Pursuant to Section 1310 of the Act, a Letter of Credit shall be issued for payment as provided for herein from the National Flood Insurance Fund.

Effective Date: October 1, 1997.

Issued By: Federal Emergency Management Agency, Federal Insurance Administration, Washington, DC 20472.

Article I—Findings, Purpose, and Authority

Whereas, the Congress in its "Finding and Declaration of Purpose" in the National Flood Insurance Act of 1968, as amended, ("the Act") recognized the benefit of having the National Flood Insurance Program (the "Program" or "NFIP") "carried out to the maximum extent practicable by the private insurance industry"; and

Whereas, the Federal Insurance Administration (FIA) recognizes this Arrangement as coming under the provisions of Section 1345 of the Act; and

Whereas, the goal of the FIA is to develop a program with the insurance industry where, overtime, some risk-bearing role for the industry will evolve as intended by the Congress (Section 1304 of the Act); and

Whereas, the insurer (hereinafter the "Company") under this Arrangement shall charge rates established by the FIA; and

Whereas, this Arrangement will subsidize all flood policy losses by the Company; and

Whereas, this Financial Assistance/Subsidy Arrangement has been developed to enable any interested qualified insurer to write flood insurance under its own name; and

Whereas, one of the primary objectives of the Program is to provide coverage to the maximum number of structures at risk and because the insurance industry has marketing access through its existing facilities not directly available to the FIA, it has been concluded that coverage will be extended to those who would not otherwise be insured under the Program; and

Whereas, flood insurance policies issued subject to this Arrangement shall be only that insurance written by the Company in its own name under prescribed policy conditions and pursuant to this Arrangement and the Act; and

Whereas, over time, the Program is designed to increase industry participation, and, accordingly, reduce or eliminate Government as the principal vehicle for delivering flood insurance to the public; and

Whereas, the direct beneficiaries of this Arrangement will be those Company policyholders and applicants for flood insurance who otherwise would not be covered against the peril of flood.

Now, therefore, the parties hereto mutually undertake the following:

Article II—Undertaking of the Company

A. Eligibility Requirements for Participation in the NFIP:

1. Policy Administration. All fund receipt, recording, control, timely deposit

requirements, and disbursement in connection with all Policy Administration and any other related activities or correspondences, must meet all requirements of the Financial Control Plan. The Company shall be responsible for:

- a. Compliance with the Community Eligibility/Rating Criteria
- b. Making Policyholder Eligibility Determinations
- c. Policy Issuance
- d. Policy Endorsements
- e. Policy Cancellations
- f. Policy Correspondence
- g. Payment of Agents' Commissions

2. Claims Processing. All claims processing must be processed in accordance with the processing of all the companies' insurance policies and with the Financial Control Plan. Companies will also be required to comply with FIA Policy Issuances and other guidance authorized by FIA or the Federal Emergency Management Agency ("FEMA").

3. Reports.

a. Monthly Financial Reporting and Statistical Transaction reporting requirements. All monthly financial reporting and statistical transaction reporting shall be in accordance with the requirements of the NFIP Transaction Record Reporting and Processing Plan for the Company Program and the Financial Control Plan for business written under the WYO (Write Your Own) Program. 44 CFR part 62, appendix B. These data shall be validated/edited/audited in detail and shall be compared and balanced against Company reports.

b. Monthly financial reporting procedure shall be in accordance with the WYO Accounting Procedures.

B. Time Standards. Time will be measured from the date of receipt through the date mailed out. All dates referenced are working days, not calendar days. In addition to the standards set forth below, all functions performed by the company shall be in accordance with the highest reasonably attainable quality standards generally utilized in the insurance and data processing field. Continual failure to meet these requirements may result in limitations on the company's authority to write new business or the removal of the Company from the program. Applicable time standards are:

1. Application Processing—15 days (note: if the policy cannot be mailed due to insufficient or erroneous information or insufficient funds, a request for correction or added moneys shall be mailed within 10 days);
2. Renewal Processing—7 days.
3. Endorsement Processing—15 days.
4. Cancellation Processing—15 days.
5. Claims Draft Processing—7 days from completion of file examination.
6. Claims Adjustment—45 days average from the receipt of Notice of Loss (or equivalent) through completion of examination.

C. Single Adjuster Program. To ensure the maximum responsiveness to the NFIP policy holders following a catastrophic event, e.g., a hurricane, involving insured wind and flood damage to policyholders, the Company shall agree to the adjustment of the combined flood and wind losses utilizing one adjuster under an NFIP-approved Single Adjuster Program using procedures issued by the

Administrator. The Single Adjuster procedure shall be followed in the following cases:

1. Where the flood and wind coverage is provided by the Company;
2. Where the flood coverage is provided by the Company and the wind coverage is provided by a participating State Property Insurance Plan, Windpool Association, Beach Plan, Joint Underwriting Association, FAIR Plan, or similar property insurance mechanism; and
3. Where the flood coverage is provided by the Company and the wind coverage is provided by another property insurer and the State Insurance Regulator has determined that such property insurer shall, in the interest of consumers, facilitate the adjustment of its wind loss by the adjuster engaged to adjust the flood loss of the Company.

D. Policy Issuance.

1. The flood insurance subject to this Arrangement shall be only that insurance written by the Company in its own name pursuant to the Act.
2. The Company shall issue policies under the regulations prescribed by the Administrator in accordance with the Act.
3. All such policies of insurance shall conform to the regulations prescribed by the Administrator pursuant to the Act, and be issued on a form approved by the Administrator.
4. All policies shall be issued in consideration of such premiums and upon such terms and conditions and in such States or areas or subdivisions thereof as may be designated by the Administrator and only where the Company is licensed by State law to engage in the property insurance business.
5. The Administrator may require the Company to discontinue issuing policies subject to this Arrangement immediately in the event Congressional authorization or appropriation for the National Flood Insurance Program is withdrawn.

E. The Company shall separate Federal flood insurance funds from all other Company accounts, at a bank or banks of its choosing for the collection, retention and disbursement of Federal funds relating to its obligation under this Arrangement, less the Company's expenses as set forth in Article III, and the operation of the Letter of Credit established pursuant to Article IV. All funds not required to meet current expenditures shall be remitted to the United States Treasury, in accordance with the provisions of the WYO Accounting Procedures Manual.

F. The Company shall investigate, adjust, settle and defend all claims or losses arising from policies issued under this Arrangement. Payment of flood insurance claims by the Company shall be binding upon the FIA.

G. The Company shall market flood insurance policies in a manner consistent with the marketing guidelines established by the Federal Insurance Administration.

Article III—Loss Costs, Expenses, Expense Reimbursement, and Premium Refunds

A. The Company shall be liable for operating, administrative and production expenses, including any State premium taxes, dividends, agents' commissions or any other expense of whatever nature incurred by the Company in the performance of its

obligations under this Arrangement but excluding other taxes or fees, such as surcharges on flood insurance premium and guaranty fund assessments.

B. The Company shall be entitled to withhold, as operating and administrative expenses, including agents' or brokers' commissions, an amount from the Company's written premium on the policies covered by this Arrangement in reimbursement of all of the Company's marketing, operating and administrative expenses, except for allocated and unallocated loss adjustment expenses described in Section C. of this Article, which amount shall be a minimum of 31.6% of the Company's written premium on the policies covered by this Arrangement.

The amount of expense allowance retained by the company may be increased to a maximum of 32.9%, depending on the extent to which the company meets the marketing goals for the 1997–1998 Arrangement year contained in marketing guidelines established pursuant to Article II.G. The amount of any increase shall be paid to the company after the end of the 1997–1998 Arrangement year.

The Company, with the consent of the Administrator as to terms and costs, shall be entitled to utilize the services of a national rating organization, licensed under state law, to assist the FIA in undertaking and carrying out such studies and investigations on a community or individual risk basis, and in determining more equitable and accurate estimates of flood insurance risk premium rates as authorized under the National Flood Insurance Act of 1968, as amended. The Company shall be reimbursed in accordance with the provisions of the WYO Accounting Procedures Manual for the charges or fees for such services.

C. Loss Adjustment Expenses shall be reimbursed as follows:

1. Unallocated loss adjustment shall be an expense reimbursement of 3.3% of the incurred loss (except that it does not include "incurred but not reported").

2. Allocated loss adjustment expense shall be reimbursed to the Company pursuant to a "Fee Schedule" coordinated with the Company and provided by the Administrator.

3. Special allocated loss expenses shall be reimbursed to the Company in accordance with guidelines issued by the Administrator.

D. Loss Payments.

1. Loss payments under policies of flood insurance shall be made by the Company from funds retained in the bank account(s) established under Article II, Section E and, if such funds are depleted, from funds derived by drawing against the Letter of Credit established pursuant to Article IV.

2. Loss payments include payments as a result of litigation which arises under the scope of this Arrangement, and the Authorities set forth above. All such loss payments must meet the documentation requirements of the Financial Control Plan and of this Arrangement. The Company will be reimbursed for errors and omissions only as set forth at Article IX of this Arrangement.

3. Notification of claims in litigation against the company. To ensure

reimbursement of costs expended to defend a claim in litigation against the Company, the Company must promptly notify FIA.

Prompt notice, in duplicate, of any such claim in litigation within the scope of this section (D) shall be sent to the FIA along with a copy of any material pertinent to the claim in litigation. FIA shall forward one copy of all such claims to the Associate General Counsel for Litigation, FEMA OGC, to ensure that the FEMA OGC is aware of all pending litigation. Following the initial notice of claims in litigation, to ensure expeditious reimbursement, the company must submit all pertinent material and billing documentation as it becomes available. Within 60 days of the receipt of a notice of claim in litigation by the Company, the Company must submit an initial case analysis and legal fee estimate for billing support. Failure to meet these notice requirements may result in the Administrator's decision not to reimburse expenses for which FIA and the FEMA OGC have not been notified in a timely manner.

4. Limitation on Litigation Costs. Following receipt of notice of such claim, the Office of General Counsel (OGC), FEMA, shall review the information submitted. If it is determined that the claim is grounded in actions by the Company that are outside the scope of this Arrangement, the National Flood Insurance Act, and 44 CFR chapter 1, subchapter B, and/or involve issues of insurer/agent negligence as discussed in Article IX of this Arrangement, the OGC shall make a recommendation to the Administrator as to whether the claim is grounded in actions by the Company that are significantly outside the scope of this Arrangement. In the event the Administrator determines that the claim is grounded in actions by the Company that are significantly outside the scope of this Arrangement, the Company will be notified, in writing, within thirty (30) days of the Administrator's decision, if the decision is that any award or judgment for damages arising out of such actions will not be recognized under Article III of this Arrangement as a reimbursable loss cost, expense or expense reimbursement. In the event that the Company wishes to petition for reconsideration the determination that it will not be reimbursed for the award or judgment made under the above circumstances, it may do so by mailing, within thirty days of the notice declining to recognize any such award or judgment as reimbursable under Article III, a written petition to the Chairman of the WYO Standards Committee established under the Financial Control Plan. The WYO Standards Committee will, then, consider the petition at its next regularly scheduled meeting or at a special meeting called for that purpose by the Chairman and issue a written recommendation to the Administrator within thirty days of the meeting. The Administrator's final determination will be made, in writing, to the Company within thirty days of the recommendation made by the WYO Standards Committee.

E. Premium refunds to applicants and policyholders required pursuant to rules contained in the National Flood Insurance Program (NFIP) "Flood Insurance Manual" shall be made by the Company from Federal flood insurance funds referred to in Article

II, Section E, and, if such funds are depleted, from funds derived by drawing against the Letter of Credit established pursuant to Article IV.

Article IV—Undertakings of the Government

A. Letter(s) of Credit shall be established by the Federal Emergency Management Agency (FEMA) against which the Company may withdraw funds daily, if needed, pursuant to prescribed procedures implemented by FEMA. The amounts of the authorizations will be increased as necessary to meet the obligations of the Company under Article III, Sections C, D, and E. Request for funds shall be made only when net premium income has been depleted. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for allowable Letter of Credit expenses.

Request for payment on Letters of Credit shall not ordinarily be drawn more frequently than daily nor in amounts less than \$5,000, and in no case more than \$5,000,000 unless so stated on the Letter of Credit. This Letter of Credit may be drawn by the Company for any of the following reasons:

1. Payment of claim as described in Article III, Section D;
 2. Refunds to applicants and policyholders for insurance premium overpayment, or if the application for insurance is rejected or when cancellation or endorsement of a policy results in a premium refund as described in Article III, Section E; and
 3. Allocated and unallocated Loss Adjustment Expenses as described in Article III, Section C.
- B. The FIA shall provide technical assistance to the Company as follows:
1. The FIA's policy and history concerning underwriting and claims handling.
 2. A mechanism to assist in clarification of coverage and claims questions.
 3. Other assistance as needed.

Article V—Commencement and Termination

A. Upon signature of authorized officials for both the Company and the FIA, this Arrangement shall be effective for the period October 1 through September 30. The FIA shall provide financial assistance only for policy applications and endorsements accepted by the Company during this period pursuant to the Program's effective date, underwriting and eligibility rules.

B. By June 1, of each year, the FIA shall publish in the **Federal Register** and make available to the Company the terms for the re-subscription of this Financial Assistance/ Subsidy Arrangement. In the event the Company chooses not to re-subscribe, it shall notify the FIA to that effect by the following July 1.

C. In the event the Company elects not to participate in the Program in any subsequent fiscal year, or the FIA chooses not to renew the Company's participation, the FIA, at its option, may require (1) the continued performance of this entire Arrangement for a period not to exceed one (1) year following the original term of this Arrangement, or any renewal thereof, or (2) the transfer to the FIA of:

1. All data received, produced, and maintained through the life of the Company's participation in the Program, including certain data, as determined by FIA, in a standard format and medium; and

2. A plan for the orderly transfer to the FIA of any continuing responsibilities in administering the policies issued by the Company under the Program including provisions for coordination assistance; and

3. All claims and policy files, including those pertaining to receipts and disbursements that have occurred during the life of each policy. In the event of a transfer of the services provided, the Company shall provide the FIA with a report showing, on a policy basis, any amounts due from or payable to insureds, agents, brokers, and others as of the transition date.

D. Financial assistance under this Arrangement may be canceled by the FIA in its entirety upon 30 days written notice to the Company by certified mail stating one of the following reasons for such cancellation: (1) Fraud or misrepresentation by the Company subsequent to the inception of the contract, or (2) nonpayment to the FIA of any amount due the FIA. Under these very specific conditions, the FIA may require the transfer of data as shown in Section C., above. If transfer is required, the unearned expenses retained by the Company shall be remitted to the FIA. In such event the Government will assume all obligations and liabilities owed to policyholders under such policies arising before and after the date of transfer.

E. In the event the Act is amended, or repealed, or expires, or if the FIA is otherwise without authority to continue the Program, financial assistance under this Arrangement may be canceled for any new or renewal business, but the Arrangement shall continue for policies in force that shall be allowed to run their term under the Arrangement.

F. In the event that the Company is unable to, or otherwise fails to, carry out its obligations under this Arrangement by reason of any order or directive duly issued by the Department of Insurance of any Jurisdiction to which the Company is subject, the Company agrees to transfer, and the Government will accept, any and all WYO policies issued by the Company and in force as of the date of such inability or failure to perform. In such event the Government will assume all obligations and liabilities owed to policyholders under such policies arising before and after the date of transfer and the Company will immediately transfer to the Government all funds in its possession with respect to all such policies transferred and the unearned portion of the Company expenses for operating, administrative and loss adjustment on all such policies.

Article VI—Information and Annual Statements

The Company shall furnish to FEMA such summaries and analyses of information including claim file information, and property address, location, and/or site information in its records as may be necessary to carry out the purposes of the National Flood Insurance Act of 1968, as amended, in such form as the FIA, in

cooperation with the Company, shall prescribe. The Company shall be a property/casualty insurer domiciled in a State or territory of the United States. Upon request, the Company shall file with the FIA a true and correct copy of the Company's Fire and Casualty Annual Statement, and Insurance Expense Exhibit or amendments thereof as filed with the State Insurance Authority of the Company's domiciliary State.

Article VII—Cash Management and Accounting

A. FEMA shall make available to the Company during the entire term of this Arrangement and any continuation period required by FIA pursuant to Article V, Section C., the Letter of Credit provided for in Article IV drawn on a repository bank within the Federal Reserve System upon which the Company may draw for reimbursement of its expenses as set forth in Article IV that exceed net written premiums collected by the Company from the effective date of this Arrangement or continuation period to the date of the draw.

B. The Company shall remit all funds, including interest, not required to meet current expenditures to the United States Treasury, in accordance with the provisions of the WYO Accounting Procedures Manual or procedures approved in writing by the FIA.

C. In the event the Company elects not to participate in the Program in any subsequent fiscal year, the Company and FIA shall make a provisional settlement of all amounts due or owing within three months of the termination of this Arrangement. This settlement shall include net premiums collected, funds drawn on the Letter of Credit, and reserves for outstanding claims. The Company and FIA agree to make a final settlement of accounts for all obligations arising from this Arrangement within 18 months of its expiration or termination, except for contingent liabilities that shall be listed by the Company. At the time of final settlement, the balance, if any, due the FIA or the Company shall be remitted by the other immediately and the operating year under this Arrangement shall be closed.

Article VIII—Arbitration

If any misunderstanding or dispute arises between the Company and the FIA with reference to any factual issue under any provisions of this Arrangement or with respect to the FIA's non-renewal of the Company's participation, other than as to legal liability under or interpretation of the standard flood insurance policy, such misunderstanding or dispute may be submitted to arbitration for a determination that shall be binding upon approval by the FIA. The Company and the FIA may agree on and appoint an arbitrator who shall investigate the subject of the misunderstanding or dispute and make a determination. If the Company and the FIA cannot agree on the appointment of an arbitrator, then two arbitrators shall be appointed, one to be chosen by the Company and one by the FIA.

The two arbitrators so chosen, if they are unable to reach an agreement, shall select a third arbitrator who shall act as umpire, and such umpire's determination shall become final only upon approval by the FIA.

The Company and the FIA shall bear in equal shares all expenses of the arbitration. Findings, proposed awards, and determinations resulting from arbitration proceedings carried out under this section, upon objection by FIA or the Company, shall be inadmissible as evidence in any subsequent proceedings in any court of competent jurisdiction.

This Article shall indefinitely succeed the term of this Arrangement.

Article IX—Errors and Omissions

The parties shall not be liable to each other for damages caused by inadvertent delay, error, or omission made in connection with any transaction under this Arrangement. In the event of such actions, the responsible party must attempt to rectify that error as soon as possible after discovery of the error and act to mitigate any costs incurred due to that error. In the event that steps are not taken to rectify the situation and such action leads to claims against the company, the NFIP, or other related entities, the responsible party shall bear all liability attached to that delay, error or omission to the extent permissible by law.

However, in the event that the Company has made a claim payment to an insured without including a mortgagee (or trustee) of which the Company had actual notice prior to making payment, and subsequently determines that the mortgagee (or trustee) is also entitled to any part of said claim payment, any additional payment shall not be paid by the Company from any portion of the premium and any funds derived from any Federal Letter of Credit deposited in the bank account described in Article II, section E. In addition, the Company agrees to hold the Federal Government harmless against any claim asserted against the Federal Government by any such mortgagee (or Trustee), as described in the preceding sentence, by reason of any claim payment made to any insured under the circumstances described above.

Article X—Officials Not to Benefit

No Member or Delegate to Congress, or Resident Commissioner, shall be admitted to any share or part of this Arrangement, or to any benefit that may arise therefrom; but this provision shall not be construed to extend to this Arrangement if made with a corporation for its general benefit.

Article XI—Offset

At the settlement of accounts the Company and the FIA shall have, and may exercise, the right to offset any balance or balances, whether on account of premiums, commissions, losses, loss adjustment expenses, salvage, or otherwise due one party to the other, its successors or assigns, hereunder or under any other Arrangements heretofore or hereafter entered into between the Company and the FIA. This right of offset shall not be affected or diminished because of insolvency of the Company.

All debts or credits of the same class, whether liquidated or unliquidated, in favor of or against either party to this Arrangement on the date of entry, or any order of conservation, receivership, or liquidation, shall be deemed to be mutual debts and credits and shall be offset with the balance

only to be allowed or paid. No offset shall be allowed where a conservator, receiver, or liquidator has been appointed and where an obligation was purchased by or transferred to a party hereunder to be used as an offset.

Although a claim on the part of either party against the other may be unliquidated or undetermined in amount on the date of the entry of the order, such claim will be regarded as being in existence as of the date of such order and any credits or claims of the same class then in existence and held by the other party may be offset against it.

Article XII—Equal Opportunity

The Company shall not discriminate against any applicant for insurance because of race, color, religion, sex, age, handicap, marital status, or national origin.

Article XIII—Restriction on Other Flood Insurance

As a condition of entering into this Arrangement, the Company agrees that in any area in which the Administrator authorizes the purchase of flood insurance pursuant to the Program, all flood insurance offered and sold by the Company to persons eligible to buy pursuant to the Program for coverages available under the Program shall be written pursuant to this Arrangement.

However, this restriction applies solely to policies providing only flood insurance. It does not apply to policies provided by the Company of which flood is one of the several perils covered, or where the flood insurance coverage amount is over and above the limits of liability available to the insured under the Program.

Article XIV—Access To Books and Records

The FIA and the Comptroller General of The United States, or their duly authorized representatives, for the purpose of investigation, audit, and examination shall have access to any books, documents, papers and records of the Company that are pertinent to this Arrangement. The Company shall keep records that fully disclose all matters pertinent to this Arrangement, including premiums and claims paid or payable under policies issued pursuant to this Arrangement. Records of accounts and records relating to financial assistance shall be retained and available for three (3) years after final settlement of accounts, and to financial assistance, three (3) years after final adjustment of such claims. The FIA shall have access to policyholder and claim records at all times for purposes of the review, defense, examination, adjustment, or investigation of any claim under a flood insurance policy subject to this Arrangement.

Article XV—Compliance With Act and Regulations

This Arrangement and all policies of insurance issued pursuant thereto shall be subject to the provisions of the National Flood Insurance Act of 1968, as amended, the Flood Disaster Protection Act of 1973, as amended, the National Flood Insurance Reform Act of 1994, and Regulations issued pursuant thereto and all Regulations affecting

the work that are issued pursuant thereto,
during the term hereof.

**Article XVI—Relationship Between the
Parties (Federal Government and Company)
and the Insured**

Inasmuch as the Federal Government is a guarantor hereunder, the primary relationship between the Company and the Federal Government is one of a fiduciary nature, i.e., to assure that any taxpayer funds are accounted for and appropriately expended. The Company is not the agent of the Federal Government. The Company is solely responsible for its obligations to its insured under any flood policy issued pursuant hereto.

(Catalog of Federal Domestic Assistance No. 83.100, "Flood Insurance")

Dated: July 18, 1997.

Spence W. Perry,

*Executive Administrator, Federal Insurance
Administration.*

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