

**APPLICATION OF INSURANCE OFFSETS  
ON DISASTER LOANS FOR THE  
MIDWEST FLOODS OF 2008**

*Report Number 9-13  
Date Issued: July 6, 2009*

**Prepared by the  
Office of Inspector General  
U.S. Small Business Administration**



U.S. Small Business Administration  
Office Inspector General

## Memorandum

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To: Steven Smith  
Chief, Executive Office of Disaster Strategic  
Planning and Operations

Date: July 6, 2009

James E. Rivera, Acting Associate  
Administrator, Office of Disaster Assistance

From: Debra S. Ritt  
Assistant Inspector General for Auditing

Subject: Audit of the Application of Insurance Offsets on Disaster Loans for the Midwest Floods of 2008, Report No. 9-13

This report summarizes the results of our audit of the *Small Business Administration's (SBA) Application of Insurance Offsets on Disaster Loans for the Midwest Floods of 2008*. Under the Stafford Act<sup>1</sup> Federal agencies administering disaster benefits must ensure that individuals receiving assistance have not already been compensated for their losses by another program, from insurance, or from any other source. The audit objective was to determine whether SBA properly reduced Midwest flood loan balances to reflect insurance offsets.

To address the audit objective, we reviewed a statistical sample of 99<sup>2</sup> of 788 active Midwest Floods disaster loans totaling \$8,942,000 for borrowers, who either were located in Flood Zone A<sup>3</sup> or who carried flood insurance, to determine whether all applicable insurance payments were identified and properly offset against each loan's verified loss. We identified flood insurance payments made to the sampled loan recipients based on information reported in the National Flood Insurance Program (NFIP) database. We identified hazard insurance payments by contacting insurance companies listed in SBA's Disaster Credit Management System electronic loan files. We also interviewed Office of Disaster Assistance (ODA) loan officers and case managers at the Disaster Loan Processing and

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<sup>1</sup> P.L. 93-288, as amended, Section 5155.

<sup>2</sup> We originally sampled 140 loans, but eliminated 41 loans that had been subsequently cancelled, which reduced the sample size to 99.

<sup>3</sup> FEMA has designated Flood Zone A as an area with a high risk of flooding, and therefore, mandatory flood insurance requirements apply.

Disbursement Center in Fort Worth, Texas to obtain an understanding of the insurance offset process used prior to loan approval and during loan disbursement.

The audit was performed between August 2008 and April 2009 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States, and included such tests considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

We found that ODA did not correctly identify or offset insurance payments on 9 of the 99 loans we sampled, which resulted in \$126,876 in duplicate benefits. Further, ODA did not take steps to recover some of the duplicate benefits after it became aware of them. The majority of the errors occurred because loan officers did not check with insurance companies to determine the amount of insurance that had been paid prior to each disbursement, as required. Because contacting the insurance companies before each disbursement may be burdensome for loan officers, we recommended that ODA revise its SOP to require confirmation of insurance payments only prior to loan approval and before the final disbursement occurs.

On June 25, 2009, both offices submitted their formal responses. Management agreed with our findings, concurred with both recommendations, and has taken action to implement the OIG recommendations.

## **BACKGROUND**

The Small Business Administration provides direct disaster loans to homeowners, renters, businesses and nonprofit organizations to help them return to pre-disaster condition. Section 5155 of the Stafford Act requires Federal agencies providing disaster assistance to ensure that businesses and individuals do not receive disaster assistance for losses for which they have already been compensated. An individual receiving Federal assistance for a major disaster shall be liable to the United States to the extent that such assistance duplicates benefits to the individual for the same purpose. Therefore, the borrower is only eligible to receive disaster loan funds in the amount of the uncompensated loss.

To comply with the Act, Standard Operating Procedure (SOP) 50 30 requires ODA to determine the borrower's uncompensated loss, which is the total verified loss due to the disaster, minus any applicable duplicate benefits. All insurance payments for the same purpose as the disaster loan are considered a duplicate benefit.

During the summer of 2008, several Midwestern states suffered approximately \$15 billion in damages due to extensive flooding. These damages resulted in

increased flood insurance claims from disaster victims. Although obtained through commercial insurance companies, all national flood insurance policies are provided by the NFIP, which is administered by the Federal Emergency Management Agency (FEMA). Consequently, FEMA maintains a record of all national flood insurance payments made to flood victims.

## **RESULTS**

### **ODA Did Not Always Correctly Account for Insurance Recoveries**

ODA did not always reduce disaster loans by insurance recoveries, which resulted in 9 loan recipients receiving \$126,876 in duplicate benefits. When we informed ODA officials or they otherwise became aware of the duplicate benefits, they took action to offset \$94,319 of the payments on 5 of the loans. However, \$32,557 must still be offset to arrive at the uncompensated loss for the 4 remaining loans. For example:

- A duplicate benefit of \$5,834 occurred on one loan, even though ODA had two opportunities to identify and correct it. Although the borrower indicated that an insurance claim was pending at loan approval, the case manager did not check on the status of the claim with the insurance company prior to issuing the final loan disbursement. Had the case manager done so, she would have identified a \$5,834 insurance claim payment. Additionally, the Agency received written notice of the insurance payment 11 days after final loan disbursement, but no action was taken to collect the duplicate payment.
- The borrower on another loan informed ODA at loan approval that she had received two separate insurance payments – one for \$5,982, and one for an unknown amount. Neither the loan officer nor the case manager contacted the insurance company during loan approval or the disbursement process to determine the amount of the second payment. According to the insurance company, the second payment was \$2,190, which should have been deducted from the SBA loan amount.
- ODA was not aware of all flood insurance payments made to a borrower on a third loan, which resulted in \$42,002 in duplicate benefits. Although the flood insurance company provided SBA with both a signed Certification of Federal Flood Insurance and a policy declaration notice, confirming that ODA had been listed as a mortgagee or lender on the policy, the insurance checks issued to the borrower did not list SBA as a co-payee. As a result, ODA was unaware of the final insurance payment until the borrower

reported it 2 months after the checks were issued. Subsequently, the Agency initiated a loan modification to offset the \$42,000<sup>1</sup> duplicate benefit.

- A \$15,000 flood insurance payment on a fourth loan resulted in a duplication of benefits. During the loan disbursement process, the borrower notified ODA of two insurance payments, which were properly offset by the Agency. However, the borrower failed to report a third insurance payment of \$15,000. The insurance company did not make the \$15,000 check co-payable to SBA, as requested in the Assignment of Insurance Proceeds (AIP) form signed by the borrower. After we informed ODA of the additional insurance payment, the Agency initiated a loan modification to offset the \$15,000 duplicate benefit.

Six of the nine errors occurred because loan officers did not contact insurance companies before loan approval or when disbursing loan funds. SOP 50 30 requires loan officers to obtain a breakdown of all insurance payments (e.g., the settlement sheet or adjuster's proof of loss) from the insurance agent prior to loan approval. Additionally, the SOP requires that a duplication of benefits check be completed before each disbursement is made to verify that all grant or recoveries have been addressed. This check is especially important because information on insurance claims may not be available before loan approval as the claims are still in process, and supplemental claims may occur subsequent to loan approval.

Despite the SOP requirements, ODA case managers interviewed told us that they generally did not verify insurance recovery amounts before approving loan disbursements as it was time consuming to contact insurance companies prior to every disbursement, and waiting for a response could unfairly delay loan disbursements to disaster victims. Further, they believed that the duplication of benefits check called for by the SOP required a check for only FEMA grants that may have been awarded to borrowers. Consequently, ODA should revise its SOP to require confirmation of insurance payments only prior to loan approval and before the final disbursement.

In the remaining three instances insurance companies ignored SBA's requests to include it as a co-payee on insurance payments, even though the three borrowers had signed AIPs, giving SBA legal claim to any insurance proceeds that duplicated benefits received from their disaster loans. Although the AIP is forwarded to the insurance company, it is strictly an agreement between SBA and the borrower, and does not require the insurance company's acknowledgement.

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<sup>1</sup> There is a \$2 discrepancy between the OIG calculation and SBA's modification. This difference was considered immaterial.

According to ODA managers we interviewed, the Agency has no legal grounds to compel the insurance companies to comply with their requests to make SBA the co-payee on insurance payments because the AIP only legally binds the borrower.

## **RECOMMENDATIONS**

We recommend that the Chief, Executive Office of Disaster Strategic Planning and Operations:

1. Revise SOP 50 30 to require confirmation of insurance payments only prior to loan approval and before the final disbursement.
2. Reduce each of the 4 loan balances by the additional offset amounts listed in Appendix I to prevent \$32,557 in duplicate benefits.

## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

On June 1, 2009 we provided the Executive Office of Disaster Strategic Planning and Operations the Office of Disaster Assistance the draft report for comment. On June 25, 2009, both offices submitted their formal responses. These comments are contained in their entirety in Appendix II. Management agreed with our findings, concurred with both recommendations, and has taken action to implement the OIG recommendations.

### **Recommendation 1**

#### *Management Comments*

Management agreed with the recommendation to revise SOP 50 30 to require confirmation of insurance payments only prior to loan approval and before final disbursement. ODA stated that it will issue a Director's Memorandum outlining the SOP change, with the change to be formally incorporated in the SOP in the next update cycle. ODA indicated that PDC training materials and course content will also be updated.

#### *OIG Response*

The OIG believes that ODA's revision of the SOP should remedy the deficiencies noted in the audit report.

## **Recommendation 2**

### *Management Comments*

Management also agreed with the recommendation to take action on each of the 4 loans listed in Appendix I to prevent \$32,557 in duplicate benefits. ODA reviewed each of these loans and took action to ensure that the noted duplications were corrected on the loans.

### *OIG Response*

The OIG believes ODA's course of action should remedy the deficiencies noted in the audit report.

We appreciate the courtesies and cooperation of the Office of Associate Administrator, Disaster Assistance; Disaster Assistance Processing and Disbursement Center and DCMS Operations Center representatives during this audit. If you have any questions concerning this report, please call me at (202) 205-[FOIA ex. 2] or Craig P. Hickok, Acting Director, Disaster Assistance Group, at (817) 684-[FOIA ex. 2].

# APPENDIX I. EXCEPTION LIST

<b>Loan Number</b>	<b>Amount Offset</b>	<b>Additional Offset Required</b>	<b>Insurance Type</b>
[FOIA ex. 2]	\$47,002	\$0	Flood
[FOIA ex. 2]	\$4,818	\$1,288	Flood
[FOIA ex. 2]	\$60,420	\$28,079	Both
[FOIA ex. 2]	\$33,170	\$0	Flood
[FOIA ex. 2]	\$5,100	\$0	Flood
[FOIA ex. 2]	\$4,250	\$0	Hazard
[FOIA ex. 2]	\$27,658	\$0	Flood
[FOIA ex. 2]	\$5,982	\$2,190	Hazard
[FOIA ex. 2]	\$82,069	\$1,000	Flood
<b>TOTAL:</b>		<b>\$32,557</b>	

# APPENDIX II. AGENCY RESPONSE - EODSPO

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U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416



Date: June 25, 2009

To: Debra S. Ritt  
Assistant Inspector General for Auditing

From: Steven G. Smith [FOIA ex. 6]  
Chief, Executive Office of Disaster Strategic Planning  
and Operations

Subject: OIG Draft Report - The Application of Insurance Offsets on Disaster Loans for the  
Midwest Floods of 2008 (Project No. 8309)

I have reviewed the draft report for the audit titled "Application of Insurance Offsets on Disaster Loans for the Midwest Floods of 2008" and the response from the Office of Disaster Assistance (ODA). The ODA response is complete and on point.

In the conduct of this audit OIG focused on a sample of 99 loans from a population of 788. The OIG draft report states that nine loans were identified where verification of insurance payments were not made prior to disbursement, resulting in duplicate benefits. The audit reports that in five of these cases, the duplicate benefit has been recouped, leaving four cases with a value of \$32,557.00 unresolved. The ODA response reports that the remaining four duplicate payments have been resolved.

The OIG recommends that EODSPO revise SOP 50 30 to require clarification of insurance payments only prior to loan approval and before final disbursement; and that each of the four loan balances be offset to prevent \$32,557.00 in duplicate benefits. ODA has the authority to revise SOP 50 30 and taken required action to implement the OIG recommendations.

Attachment: The ODA response to OIG Project 0309.

Copy to:  
Administrator  
Chief of Staff  
Associate Administrator Disaster Assistance

# APPENDIX II. AGENCY RESPONSE - ODA

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U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416



Date: JUN 25 2009

To: Debra S. Ritt  
Assistant Inspector General for Auditing

Thru: Steven G. Smith [FOIA ex. 6]  
Chief, EODSPO [FOIA ex. 6]

From: James Rivera  
Acting Associate Administrator  
Office of Disaster Assistance

Subject: OIG Draft Report – Application of Insurance Offsets on Disaster Loans for the Midwest Flood of 2008 (Project No. 8309)

We have reviewed the Draft Report regarding the Application of Insurance Offsets on Disaster Loans for the Midwest Floods of 2008. Our response indicates our concurrence with your recommendations. Our comments are noted below:

## OIG RECOMMENDATIONS AND AGENCY RESPONSE

Recommendation # 1: *Revise SOP 5330 to require confirmation of insurance payments only prior to loan approval and before the final disbursement.*

*ODA Response: ODA concurs with this recommendation, and will address it in two distinct sections below.*

### Confirmation of Insurance Payments Prior to Loan Approval:

SBA requires the applicant to disclose insurance coverage and settlements for all disaster damaged losses to the loan officer on the SBA application. Our current guidance requires loan officers to discuss insurance coverage and settlements with all applicants at the time of original processing. Additionally, the loan officer is required to attempt to contact the insurance agent (SOP paragraph 73.1(3)) to verify any settlements to date and the status of any open claims. SBA cannot guarantee an insurance carrier will respond to our inquiry during the original loan decision process. SOP paragraph 44.d requires the following specific procedures to be followed when final amount of the settlement cannot be determined at original processing:

d. Assignments of Pending or Future Insurance Recoveries.

- (1) If you know the amount of an insurance settlement at the time of loan processing, you deduct it from the SBA verified total loss.
- (2) If you do not know the full amount of an insurance settlement at the time of processing, you only deduct the known amount. This arises when an insurance claim for disaster damage:
  - (a) Has not yet been processed or settled;
  - (b) Has been only partially processed or settled; or
  - (c) Is in dispute, or when an applicant claims that additional insurance coverage may be due.
- (3) You must include an appropriate stipulation in the LAA providing for an assignment of any pending insurance settlement as follows:
  - (a) If additional amounts are expected, use the appropriate LAA stipulation to take an assignment of any insurance proceeds in excess of the amount deducted.
  - (b) If no insurance is deducted but some is expected, use the appropriate LAA stipulation to take an assignment of any insurance proceeds

We believe the above procedures, as expressed in the SOP and LO Training materials and guidance, adequately address any concerns by the IG of the current insurance offset policies and procedures for loan officers during the loan origination process. ODA will reinforce this requirement, and the need for clear documentation of attempts to contact insurance carriers and other attempts to confirm insurance payments.

Confirmation of Insurance Payments :

Paragraph 95.a of SOP 50 30 should be amended as follows:

a. All Loans...

- (4) **You must check to determine that all DOBs (e.g. FEMA, State and local grants, insurance, etc.) have been addressed.** If you determine a possible DOB exists, forward the case file to loan modification to address any potential DOB. A disbursement may be made with LP concurrence where it is clear that the pending disbursement will not constitute a DOB and the appropriate loan modification will be made after the disbursement. **(This policy must be followed prior to all disbursements including full or subsequent final disbursements.)**

# APPENDIX II. AGENCY RESPONSE - ODA

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ODA will issue a Numbered Director's Memo outlining the SOP change addressed herein, with the change to be formally incorporated in the SOP in the next update cycle. PDC training materials and course content will be updated to address the changes, and staff shall be advised at the team level by leads and supervisors.

*Recommendation #2: Reduce each of the 4 loan balances by the additional offset amounts listed in Appendix I to prevent \$32,557 in duplicate benefits.*

*ODA Response: ODA concurs with this recommendation and has taken the following actions on each of the 4 loans listed in Appendix I to prevent \$32,557 in duplication of benefits.*

1. **DCS loan** [FOIA ex. 2] "SBA knew originally that the borrower was getting a \$4,818 insurance payment from an AIP received prior to approval. However, the insurance company actually paid the borrower \$6,106 after the loan was fully disbursed. The borrower called the PDC to report the payment since the first \$6,106 included SBA as a co-payee. The PDC referred it to the El Paso servicing center who did not act on it, only noting it in a chron entry. The insurance co. cancelled the check and reissued a new check also for \$6,106 but this time excluded SBA as a co-payee. The borrower did not return the extra funds to SBA."

*ODA Response: File was recalled from servicing, and additional insurance proceeds accounted for in LMOB. File was over disbursed by \$1300, and we received a check from the borrowers in this amount. File is no longer over disbursed and was returned to the servicing office.*

2. **DCS loan** [FOIA ex. 2] AIP signed by borrower indicated that 1 dollar was paid for contents although the borrower had already informed SBA on August 2nd that the contents payout was just under \$5k. On October 1, 2008 SBA talked to borrower and borrower confirmed that they received \$5,169 for contents. On October 23, 2008 SBA contacted insurance company and was told that \$4,169 was paid to borrower. On October 28, 2008 SBA disbursed \$6,400 (subtracting only \$4,169 for flood contents payout) Note, overage is only \$1,000 because the \$125 was paid for the adjuster's fee."

*ODA Response: Upon review subsequent to this audit, the loan was found to have been paid in full and no further action was taken.*

3. **DCS loan** [FOIA ex. 2] "The borrower informed SBA at loan approval that she received two separate insurance payments – one for \$5,982, and one for an unknown amount. Neither the loan officer or case manager contacted the insurance company during the loan approval or disbursement to verify the amount of the second payment. As a result, the second check for \$2,190 was not reduced as an insurance offset."

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*ODA Response: The file was recalled from servicing and LMOD entered to account for this additional recovery. The borrowers provided documentation to support the increased costs and the PDC Loss Verification department determined increases in the verified losses were justified. The re-verification corrected the over-disbursed amount on this loan. Compensation from all sources no longer exceeds verified loss. Accordingly, the recommendation has been fully addressed, and no further action is required.*

4. DCS loan [FOIA ex. 2] "SBA didn't know about homeowners \$31,731. Also, supplemental 3k flood paid after full disbursement and SBA was not notified. Borrower told SBA well before initial disbursement that they were paid \$25 for PP (homeowners ins). However, SBA did not act on it. SBA received AIP from borrower that stated 60,419 was paid. Actual original amount paid was 60,494. But, SBA's chron entry regarding verification with the insurance company says the payout was \$60,419."

*ODA Response: This file has been recalled from servicing to address the over-disbursement and DOB that was missed. The borrowers provided documentation to support the increased costs and the PDC Loss Verification department determined increases in the verified losses were justified. The re-verification corrected the over-disbursed amount on this loan. Compensation from all sources no longer exceeds verified loss.*