

February 2000

# DISASTER ASSISTANCE

## Issues Related to the Development of FEMA's Insurance Requirements



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**G A O**

Accountability \* Integrity \* Reliability

**United States General Accounting Office  
Washington, D.C. 20548**

**General Government Division**

B-284432

February 25, 2000

The Honorable Christopher S. Bond  
Chairman  
The Honorable Barbara Mikulski  
Ranking Minority Member  
Subcommittee on VA, HUD,  
and Independent Agencies  
Committee on Appropriations  
United States Senate

The Honorable James T. Walsh  
Chairman  
The Honorable Alan Mollohan  
Ranking Minority Member  
Subcommittee on VA, HUD,  
and Independent Agencies  
Committee on Appropriations  
House of Representatives

As required by the Conference Report accompanying the fiscal year 2000 appropriations bill for Veterans Affairs, Housing and Urban Development, and Independent Agencies,<sup>1</sup> we are reporting on the Federal Emergency Management Agency's (FEMA) plans to revise its regulations pertaining to public assistance insurance requirements. Specifically, FEMA is proposing that funding under the Public Assistance Program for buildings damaged in a disaster be limited to those state and local agencies and other public entities that maintain specified minimum levels of insurance coverage. According to FEMA, the draft regulation is intended to remove a disincentive under current rules for such entities to both carry insurance and manage their risk of disasters. The Conference Report notes that FEMA's draft regulation could have significant financial implications for states, municipalities, and private nonprofit hospitals and universities.

As agreed with your offices, we evaluated FEMA's efforts to develop its draft insurance regulations. Specifically, we (1) determined the extent that FEMA obtained and incorporated input from state and local agencies and public entities likely to be affected by the draft regulation; (2) evaluated FEMA's compliance with Executive Order 12866, the Regulatory Flexibility

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<sup>1</sup> House Report 106-379, p. 150.

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Act, and applicable guidance governing the rulemaking process; and (3) assessed FEMA's internal rulemaking processes and procedures.

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## Results in Brief

During the process of drafting its insurance regulations, FEMA took a number of steps to obtain and incorporate input on the content of its draft regulation from representatives of state and local government entities. From January through October 1999, FEMA met with various groups, including public risk managers, emergency management service agencies, state insurance commissioners, and insurance companies and organizations. Based on input received from these meetings, FEMA appeared to have made a number of changes to its draft regulation. For example, FEMA amended its draft regulation to include blanket versus building-specific coverage<sup>2</sup> and incorporated a premium ceiling.

As required by Executive Order 12866<sup>3</sup> for significant regulatory actions, FEMA submitted its draft notice of proposed rulemaking to the Office of Management and Budget (OMB) on July 2, 1999, for its review and clearance. However, at the time of its submission, FEMA had not addressed two of three key requirements contained in the executive order and related OMB guidance for economically significant regulatory actions.<sup>4</sup> Specifically, FEMA had not performed an analysis of the expected costs and benefits of the draft regulation, and had not prepared a comprehensive analysis of other alternatives.

In response to our preliminary discussions with FEMA about these issues, FEMA entered into a contract with a management consulting firm to conduct a cost-benefit analysis and to examine and assess alternative approaches. In addition, FEMA began additional analysis of the impact of its draft regulation on small entities, such as local government agencies and nonprofit organizations, in response to OMB's concerns about FEMA's compliance with the Regulatory Flexibility Act.<sup>5</sup> Finally, FEMA decided in

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<sup>2</sup> Insurance can be purchased on a building-specific basis or on a blanket-policy basis for a group of buildings. A blanket policy is typically more inexpensive, since it assumes that only a portion of the total buildings covered by the policy would get badly damaged in any one event.

<sup>3</sup> Executive Order 12866, Regulatory Planning and Review, was issued on September 30, 1993, and covers all agencies except independent regulatory agencies.

<sup>4</sup> Executive Order 12866 defines four types of significant regulatory actions. OMB uses the term economically significant for one of the four types of significant regulatory actions. Economically significant regulatory actions are those that will have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy; a sector of the economy; productivity; competition; jobs; the environment; public health or safety; or state, local, or tribal governments or communities.

<sup>5</sup> 5 U.S.C. 601-612.

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January 2000 to issue an advance notice of proposed rulemaking (ANPR) before issuing a notice of proposed rulemaking, which will provide affected parties an additional opportunity to provide input and provide additional time for FEMA to complete the various required analyses.

Many of the problems we observed with the processes FEMA followed in developing the draft regulation appeared to be the result of weaknesses in FEMA's internal rulemaking processes and procedures. For example, FEMA has not designated a Regulatory Policy Officer to oversee the agency's rulemaking efforts as required by Executive Order 12866. In addition, FEMA's internal guidance and procedures governing the formulation of proposed rulemaking have not been updated in more than 10 years. This report contains recommendations that address these concerns.

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## Background

When disasters such as floods, tornadoes, or earthquakes strike, state and local governments are called upon to help citizens cope. FEMA may provide assistance if the President, at a state governor's request, declares that a major disaster or emergency exists and that federal resources are required to supplement state and local resources. The 1988 Robert T. Stafford Disaster Relief and Emergency Assistance Act<sup>6</sup> authorizes the President to issue major disaster or emergency declarations and specifies the types of assistance the President may authorize.

Under the Stafford Act, FEMA may make public assistance grants to state and local governments and certain nonprofit organizations for the repair of public facilities, such as government buildings, water distribution systems, parks and recreational facilities, and public utilities.<sup>7</sup> FEMA may make public assistance grants to these entities for three general purposes: the removal of debris, emergency protective measures,<sup>8</sup> and permanent restoration. There are five categories of permanent restoration work: (1) road and bridge systems; (2) water control facilities; (3) public buildings/equipment; (4) public utilities; and (5) other, e.g., parks and recreation. As shown in table 1, the permanent restoration of buildings represents the largest single cost category under the Public Assistance Program from October 1988 through April 1999.

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<sup>6</sup> 42 U.S.C. 5121 et al.

<sup>7</sup> FEMA also provides assistance to individuals, such as disaster-related unemployment benefits, temporary housing, and cash grants for clothing and medical expenses.

<sup>8</sup> Emergency protective measures are activities undertaken to save lives and protect the public's health and safety; examples include search and rescue operations, security measures, and demolition and removal of damaged structures.

**Table 1: Projected Public Assistance Costs by Category From October 1988 Through April 1999**

<b>Cost category</b>	<b>Total costs from October 1988 through April 1999 (in billions)</b>	<b>Percent of total costs for all categories</b>
Debris removal	\$2.6	15
Emergency protective work	3.1	18
Permanent restoration		
Roads and streets	1.9	11
Water control facilities	.5	3
Buildings	5.4	31
Utility distribution systems	2.3	13
Public parks	.9	5
Grantee/subgrantee management costs	.4	3
<b>Total</b>	<b>\$17.0</b>	<b>100</b>

Note: Data include cost projections for major disaster declarations, emergency declarations, and Fire Suppression Assistance grants.

Note: Totals may not add due to rounding.

Source: FEMA.

## Key Federal Rulemaking Requirements

A number of federal laws and executive orders govern the federal rulemaking process. The Administrative Procedure Act of 1946 is the basic law underlying all federal rulemaking.<sup>9</sup> While the act has a number of specific requirements, it requires an agency to (1) publish a notice of proposed rulemaking in the Federal Register and (2) provide interested parties with the opportunity to participate in and comment on the rulemaking.<sup>10</sup> In reviewing FEMA’s actions in developing its insurance rules, we focused primarily on the rulemaking requirements found in Executive Order 12866, which provides specific guidance on regulatory actions likely to have an economic impact on state and local governments and other public entities, and the Regulatory Flexibility Act, which governs rules impacting on small entities, both private and public.

Executive Order 12866 sets forth the processes and procedures agencies are expected to follow during rulemaking. For those actions deemed to be significant, as defined in the executive order, agencies must provide OMB with the draft regulation, a description of the need for the action, an explanation of how the planned action will meet that need, and a discussion of the costs and benefits.

<sup>9</sup> 5 U.S.C. 553 is the Administrative Procedure Act’s primary rulemaking section.

<sup>10</sup> Appendix I contains a fuller description of the requirements of the Administrative Procedure Act of 1946, the Regulatory Flexibility Act, and Executive Order 12866.

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In addition, for economically significant regulatory actions, agencies are to provide OMB with (1) an assessment of the costs and benefits anticipated from the planned regulation, including the underlying economic analysis, and (2) an assessment of feasible alternatives with an explanation of why the planned action is preferable. OMB's formal review of the proposed regulatory action does not even begin until the agency has provided all of the required information. Furthermore, all the information and analyses that are required for such regulations must also be made available to the public once a notice of proposed rulemaking has been published in the Federal Register. The executive order also requires that agencies seek to involve those likely to benefit from or to be burdened by the proposed regulation before issuing a notice of proposed rulemaking.

The Regulatory Flexibility Act directs all agencies to give particular attention to the potential impact of regulations on small entities—small businesses, small organizations, and small governmental jurisdictions—and requires consideration of regulatory alternatives that are less burdensome to small entities. Under the act, the agency must prepare an initial regulatory flexibility analysis of the proposed rule's economic impact on small entities, including (1) a description and estimate of the number of small entities to which the proposed rule will apply and (2) a description of alternatives that would minimize the impact on small entities. The analysis is not required if the agency head certifies that the proposed rule will not “have a significant economic impact on a substantial number of small entities.” If a regulatory flexibility analysis is required, the initial analysis must be published in the notice of proposed rulemaking, and the final analysis must accompany the final rule in the Federal Register.

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## Scope and Methodology

To determine the extent that FEMA obtained and incorporated input from entities likely to be affected by its draft regulation, we obtained and reviewed data from FEMA regarding the various meetings it held and changes it made to the draft regulation as a result of these meetings. We also obtained and analyzed letters submitted by state and local agencies to FEMA regarding its draft regulation. In addition, we interviewed FEMA staff involved in these meetings, as well as selected representatives of state and local agencies that either participated in the meetings or submitted letters to FEMA on its draft insurance regulation.

To evaluate the extent of FEMA's compliance with relevant federal laws, executive orders, and guidance governing the rulemaking process, we spoke with OMB officials and researched pertinent federal laws, executive orders, and OMB guidance. We also held discussions with FEMA officials

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to understand what FEMA did to comply with the applicable federal laws, executive orders, and OMB guidance. We obtained information from FEMA regarding the steps and supporting analysis that it performed in developing the draft regulation. We then compared FEMA's activities and analysis to the previously identified federal laws, executive orders, and guidance to assess the extent of compliance. In evaluating the economic analyses undertaken by FEMA, we focused on the design and methodology of the studies rather than the calculations or the resulting conclusions. OMB officials stated that they were precluded from discussing ongoing rulemaking with outside parties and referred us to FEMA for key questions we raised. As a result, we generally relied on FEMA's representations of OMB's comments on its draft insurance regulation.

To assess FEMA's internal rulemaking processes and procedures, we interviewed FEMA officials involved in developing the insurance regulation and senior management officials to obtain information on the guidance that they received during their rulemaking efforts. We also obtained and reviewed FEMA's internal policies, procedures, and guidance governing the rulemaking process. Lastly, we held discussions with senior FEMA officials to obtain information regarding the organizational structure and responsibilities for rulemaking. We conducted our review from November 1999 to January 2000 in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from FEMA. FEMA provided written comments that are included in appendix III. A summary of FEMA's comments and our responses are presented at the end of the letter.

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## **FEMA Made Efforts to Obtain and Incorporate Input From Stakeholders**

In developing the draft regulation, FEMA made efforts to obtain and incorporate input from those expected to be benefited or burdened by it as called for in Executive Order 12866. FEMA conducted a sequence of meetings with various "stakeholders" during 1999. In these meetings, FEMA obtained stakeholders' input and reaction. The draft rule was modified as suggested changes were incorporated. FEMA met with public risk managers, state emergency managers, the National Association of Insurance Commissioners, National Governor's Association, schools and universities, and insurance industry groups and companies. (See app. II for a chronology of these meetings and other key events associated with FEMA's draft insurance regulation.) According to FEMA, its draft insurance regulation reflects and incorporates the comments, concerns, and ideas of many contributors from outside the agency. FEMA received

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over 100 letters from public entities, mostly based in California, which expressed concerns about FEMA's draft regulations.

In January 1999, FEMA held six meetings across the country with public risk managers. The meetings were organized by the Public Risk Management Association and were held in the states of California, Texas, Massachusetts, Florida, Missouri, and Washington. A total of 51 public risk managers and other attendees from various states and local government agencies participated in the six meetings. According to FEMA, a number of changes were made to the draft regulation to address concerns that were raised during the meetings. For example, FEMA amended its insurance proposal to allow the use of an all-risk blanket insurance policy rather than requiring policies on an individual hazard- and building-specific basis. In addition, FEMA adopted a suggestion to extend the phase-in period of its insurance requirements from 2 to 3 years.

FEMA, in conjunction with the National Emergency Management Association, subsequently held a meeting in Washington, D.C., on March 16, 1999, to discuss and hear reaction to its insurance proposal. Eleven non-FEMA participants attended this meeting, including representatives of the emergency management agencies of the states of Florida, California, Mississippi, Louisiana, and Hawaii. Based on input received during this meeting, FEMA made additional changes to its insurance proposal, including the elimination of the requirement for predisaster insurance coverage of the contents of a building and broadening the self-insurance option to include local governments and private nonprofit organizations.<sup>11</sup>

FEMA made further changes to its insurance proposal based on input received during its subsequent meetings with various representatives of the state insurance commissioners and the insurance industry. For example, FEMA stated that based on a meeting held with the National Association of Insurance Commissioners, FEMA adopted a premium ceiling of 30 cents per \$100 of the insurable building value to limit the maximum amount that an entity would be expected to pay for insurance coverage. FEMA also indicated that it made changes to the required insurance amounts for earthquakes, floods, and wind disasters, and the maximum allowable deductible, based on these latter meetings.

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<sup>11</sup> FEMA is proposing to limit the self-insurance option to those state, local government, or public entities that establish that they have a viable plan to cover losses. At a minimum, it must have (1) a sufficiently large number of independent loss exposures to make its losses highly predictable and (2) an established fund to which it makes regular contributions and from which losses are paid.

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FEMA received a number of letters from state and local public entities expressing concerns about its draft regulation. Over 110 public entities—water districts, school districts, cities, and others—located in California wrote to FEMA citing concerns over increased administrative costs, increased insurance costs, mandated types of insurance, and rigid postdisaster insurance thresholds. A California official we contacted explained that the cost of insurance was a particular concern in California due to its high exposure to earthquakes. FEMA also received a letter from Georgia and another from Virginia expressing similar concerns. According to FEMA, another frequently expressed concern was that the insurance proposal would be set in stone once it was published as a notice of proposed rulemaking. FEMA stated that this concern was unfounded and that it planned to continue to take full advantage of input received on its draft insurance regulation.

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## **FEMA Had Not Completed the Analysis Required for Economically Significant Regulations**

Early in the process of developing the insurance rule, FEMA indicated that the rule was not a significant regulatory action. FEMA subsequently designated the rule as economically significant when it submitted the rule to OMB on July 2, 1999, as a draft notice of proposed rulemaking. Nevertheless, as of January 21, 2000, FEMA had not completed the economic analyses required by Executive Order 12866 for proposed regulatory actions likely to have a significant economic impact. Furthermore, FEMA had not completed the analysis required by the Regulatory Flexibility Act of the economic impact the proposed regulation would have on small entities. FEMA has since undertaken efforts to conduct additional economic analyses. In addition, FEMA decided in January 2000 to issue its insurance proposal as an ANPR before issuing a notice of proposed rulemaking to allow affected parties an additional opportunity to provide input and to provide additional time for FEMA to complete the various required economic analyses.

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## **FEMA Still in the Process of Addressing Executive Order 12866 Requirements**

At the time of our review, FEMA had not completed the actions required by Executive Order 12866 for economically significant regulatory actions. This may, in part, be due to FEMA's initial judgment that the rule was not a significant regulatory action, let alone an economically significant one. For those regulatory actions that are considered to be economically significant, agencies are required to perform a cost-benefit analysis of the proposed regulatory action. According to OMB's "best practices" guidance, a federal agency's cost-benefit analysis should contain three basic elements: (1) a statement of the need for the proposed action, (2) an examination of alternative approaches, and (3) an analysis of the benefits and costs.<sup>12</sup> FEMA had addressed the statement of need requirement but

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<sup>12</sup> Economic Analysis of Federal Regulations Under Executive Order 12866, Office of Management and Budget, Jan. 11, 1996. The OMB guidance was the a result of a 2-year study conducted by an

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had not performed a comprehensive analysis of alternatives or a cost-benefit analysis. In response to our preliminary observations, FEMA contracted with an outside firm in December 1999 to conduct the required analyses.

FEMA's statement of need

FEMA's July 2, 1999, submission to OMB stated that the draft regulations were intended to better meet the intent of the Stafford Act, by encouraging individuals, states, and local governments to protect themselves by obtaining insurance coverage to supplement or replace government assistance. FEMA stated that as currently designed, the Public Assistance Program promotes the purchase of building and content insurance coverage only as a postdisaster condition of the grant, and only in the amount of the eligible damages to the building and contents. According to FEMA, "knowing that the Public Assistance Program would fund building repairs following a presidential declared major disaster could be a disincentive to purchase the levels and types of insurance necessary that [public] building owners would otherwise purchase." FEMA staff stated that the current insurance regulations were inequitable in that they penalized those state and local governments that took prudent efforts to purchase appropriate insurance coverage to guard against the risk of disasters. FEMA also stated in its submission to OMB that it believed that its proposal would help reduce disaster costs for building repair.

FEMA's analysis of regulatory alternatives

For the analysis of alternatives to the proposed regulatory action, the only alternative FEMA considered in its July 2, 1999, submission to OMB was that of taking no action. In its draft rulemaking submission, FEMA stated that it believed no alternatives to the proposed rule existed that would accomplish the stated objective. According to the documentation submitted by FEMA to OMB, the only alternative was no action, which would cause continued reliance on federal disaster funds to financially compensate building owners for disaster damages. However, our discussions with FEMA staff, state officials, and outside insurance industry observers identified several other alternatives that FEMA could have recognized and discussed in its draft rule documentation. For example, one state official we contacted stated that FEMA could achieve cost reductions by providing clearer and more stringent criteria defining what constitutes a federal disaster. Other alternatives that FEMA staff stated that they could have considered included eliminating the eligibility of certain types of structures or facilities (e.g., beaches and municipal-owned businesses) and eliminating eligibility for facilities that have received

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interagency group that included representatives of all the major regulatory agencies and was co-chaired by a member of the Council of Economic Advisers.

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significant federal disaster assistance on multiple occasions. A discussion of these and/or other alternatives would have helped FEMA meet the requirements of Executive Order 12866.

**FEMA's analysis of potential costs and benefits**

FEMA undertook two separate economic studies as part of its development of the insurance regulations. The first study, which started in January 1999, attempted to measure the probable cost reductions that would accrue to the Public Assistance Program. The second study, which started in May 1999, estimated the potential financial impact of complying with the insurance coverage requirements on state and local public entities. However, both studies—the financial impact study in particular—contained serious design and methodology weaknesses that limited any conclusions that could be reached on their results. For example, the cost savings analysis did not have any analytical basis for the assumption used to estimate the effect on FEMA's expenditures of limiting premiums to a maximum of 30 cents per \$100 of insurable building value. The financial impact study had even more severe limitations, including an inability to generalize its results beyond the 43 survey respondents, because of serious sampling bias and low response rates. FEMA staff agreed that these studies, neither separately nor together, constituted a cost-benefit analysis as required by Executive Order 12866 for economically significant regulations. They told us that they were not aware of the cost-benefit analysis requirement or of the relevant OMB guidance governing such analyses at the time these studies were conducted.

**Outside firm hired to conduct additional economic analyses**

FEMA staff agreed with our preliminary observations regarding FEMA's lack of compliance with the analysis requirements of Executive Order 12866 and the associated OMB guidance. FEMA subsequently entered into a contract with an outside firm in December 1999 to conduct additional economic analyses. The contract calls for the contractor to address each of the three elements contained in OMB's best practices guidance. The contractor was to provide FEMA with a first draft of their analysis by mid-February 2000, and to complete their work by March 2000.

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**FEMA Is Undertaking Additional Regulatory Flexibility Act Analyses**

FEMA is conducting additional analysis of the potential economic and other impacts of its draft insurance regulation on small entities, such as small not-for-profit organizations and local government agencies. Under the Regulatory Flexibility Act, agencies are required to prepare an initial regulatory flexibility analysis when they publish a notice of proposed rulemaking, unless the head of the agency certifies that the rule would not have a significant economic impact on a substantial number of small entities. In its July 2, 1999, submission to OMB, FEMA concluded that its insurance proposal would not affect a significant number of small entities,

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such as small not-for-profit organizations or local government agencies. However, FEMA documents and officials stated that OMB subsequently raised concerns about FEMA's Regulatory Flexibility Act assessment of the impact of the draft regulation on small entities.

In its July 2 submission to OMB, FEMA stated that "This rule could affect all state and local governments and eligible private nonprofit facilities, since every area of the country potentially faces disasters, and therefore it is prudent to purchase insurance to protect against building damage." FEMA further stated that it presumed that all small entities already have some form of insurance. Therefore, FEMA expected that there would be no substantial increase in reporting and recordkeeping except after a disaster, when eligible entities would have to provide information on their insurance coverage. According to FEMA, it did not anticipate any requirements for "professional skills" not already used by small entities. Specifically, FEMA expected that most entities already use risk managers, accountants, and financial analysts.

According to FEMA staff, OMB stressed the need for FEMA to revise its analysis and advised FEMA that it would not be credible for it to argue that small entities would not be affected because they are already buying insurance. FEMA staff said that OMB wanted FEMA to provide data about the expected economic impacts on small entities so that the public can comment on FEMA's analysis and conclusions. FEMA officials have now determined that a Regulatory Flexibility Act analysis is necessary. However, they have not yet determined the significance of the impact on small entities.

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## FEMA Will Now Issue An Advance Notice of Proposed Rulemaking

FEMA officials stated that at OMB's suggestion they have decided to issue their insurance proposal as an ANPR, which will include a 45-day comment period, instead of immediately going forward with a notice of proposed rulemaking. While the Administrative Procedure Act does not provide for the publication by an agency of an ANPR, some regulatory statutes require agencies to begin their rulemaking by publishing an ANPR in the Federal Register, and other agencies may also use that mechanism if they choose. Generally, an ANPR notifies the public that an agency is considering an area for rulemaking and usually requests written comments on the appropriate scope of the rulemaking or specific topics. As of February 10, 2000, OMB was in the process of reviewing the draft ANPR. FEMA staff explained that the ANPR would allow affected parties an additional opportunity to provide comments and facts. In addition, FEMA officials stated that the ANPR would also allow FEMA additional time to complete

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the previously discussed economic analyses required by Executive Order 12866 and the Regulatory Flexibility Act.

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## FEMA's Policies and Procedures on the Rulemaking Process Are Outdated

In our review of FEMA's effort to develop its draft insurance regulation, we noted that FEMA lacks current and up-to-date written procedures and guidance for program staff to follow in developing proposed regulatory actions. FEMA has not updated its internal written policies and procedures or external regulations<sup>13</sup> on the rulemaking process since June 15, 1987. In addition, FEMA has also not designated a Regulatory Policy Officer, as required by Executive Order 12866, to oversee the rulemaking process.

Executive Order 12866 requires each agency to designate a Regulatory Policy Officer who is to report to the agency head. According to the executive order, the Regulatory Policy Officer is to be involved at each stage of the regulatory process to foster the development of effective, innovative, and least burdensome regulations and to further the principles of the executive order. The absence of a Regulatory Policy Officer may partially explain some of the problems FEMA experienced in complying with federal rulemaking requirements during the development of its draft insurance regulation.

The need for a Regulatory Policy Officer charged with making decisions based on up-to-date guidance was evident in FEMA's apparent confusion as to whether its draft insurance regulation was economically significant under Executive Order 12866. In its April 1999 Unified Agenda submission in the Federal Register, FEMA indicated that it believed that its insurance proposal was not a significant regulatory action, much less an economically significant one. According to FEMA officials, they did not initially believe that their draft insurance regulation would have an annual economic impact of \$100 million or more on state and local governments and public entities or otherwise fall within the executive order's definition of significant regulatory actions.

FEMA subsequently designated the proposed regulatory action as economically significant in its July 2, 1999, submission to OMB. FEMA staff explained that they changed the designation to economically significant in response to preliminary feedback provided by OMB and concerns raised by state and local public entities on earlier drafts of the proposal. However, in its October 1999 Unified Agenda submission, FEMA designated the draft insurance regulation as "other significant," indicating a rule that, while significant and therefore subject to OMB's review under

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<sup>13</sup> 44 C.F.R. Part 1.

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Executive Order 12866, is not considered to be economically significant by the agency. Based on our discussions with FEMA officials, FEMA is now treating its draft insurance proposal as an economically significant regulatory action.

FEMA's July 2, 1999, draft insurance proposal also contained other evidence of the need for updated internal guidance and procedures. FEMA cited two executive orders that had been previously revoked. FEMA cited Executive Order 12291, which had been revoked on September 30, 1993. In addition, FEMA cited Executive Order 12778, Civil Justice Reform, which had been revoked on February 5, 1996.

According to FEMA officials, FEMA has had relatively little experience in complying with the requirements of Executive Order 12866 that apply to rules that are economically significant. Data we obtained indicated that, other than the insurance regulation that we have reviewed, none of the rules submitted to OMB by FEMA since the executive order was enacted were considered to be economically significant.

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## Conclusions

FEMA obtained and incorporated input from representatives of some key stakeholders likely to be affected by the draft insurance regulation. However, FEMA has not completed the analyses required for an economically significant regulatory action during the development of its draft insurance regulation. As demonstrated by historically large expenditures for buildings under the Public Assistance Program, FEMA's proposed regulatory action could have a significant fiscal impact on some state and local public entities, particularly those in states such as California that have a high exposure to earthquakes. Thus, as required by the Regulatory Flexibility Act and Executive Order 12866, FEMA must demonstrate that it has considered viable alternatives and selected the option that imposes the least burden on the state and local public entities while achieving its goal of promoting prudent and appropriate insurance coverage before, as well as after, a disaster strikes. FEMA has acknowledged the weaknesses in its efforts to develop its draft regulation, specifically, its failure to discuss alternatives and to perform a cost-benefit analysis as required. However, FEMA is now taking corrective action. Nevertheless, based upon our analysis of how FEMA developed its draft insurance proposal, FEMA has not maintained up-to-date processes and procedures to provide reasonable assurances that future rulemaking will comply with relevant federal laws, executive orders, and OMB guidance.

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## Recommendations

To help ensure that its rulemaking process complies with the requirements contained in federal laws, executive orders, and OMB guidance, we recommend that the Director of FEMA

- designate a Regulatory Policy Officer, as required under Executive Order 12866, and charge that individual with responsibility for being involved at each stage of the rulemaking process;
- update its external regulations and internal written guidance and manuals governing the rulemaking process to reflect the current requirements contained in federal laws, executive orders, and OMB guidance; and
- monitor FEMA's compliance with relevant federal laws, executive orders, and OMB guidance governing the rulemaking process.

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## Agency Comments and Our Evaluation

We received a letter dated February 7, 2000, on a draft of this report from the Director of FEMA, which is reprinted in appendix III. The Director stated that the draft report provided a reasonable and balanced analysis and that the recommendations were helpful. He also stated that FEMA expected to formalize the appointment of a Regulatory Policy Officer in short order. The Director indicated that FEMA's General Counsel has been asked to update FEMA's regulations and guidance governing the rulemaking process. He stated that it was important to have procedures in place to deal with future economically significant regulatory actions. The Director also provided technical comments, which we have incorporated where appropriate.

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As agreed with your office, we are sending copies of this report to Senator Ted Stevens, Chairman, and Senator Robert Byrd, Ranking Minority Member, Senate Appropriations Committee; and Representative C.W. Bill Young, Chairman, and Representative David Obey, Ranking Minority Member, House Appropriations Committee. We are also sending copies of this report to the Honorable James Lee Witt, Director, Federal Emergency Management Agency. Copies will also be made available to others on request.

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If you or your staff have any questions regarding this letter, please contact Thomas J. McCool at (202) 512-8678, Lynn H. Gibson at (202) 512-8153, or Lawrence Cluff at (202) 512-8678. Key contributors to this report are acknowledged in appendix IV.



Thomas J. McCool  
Director, Financial Institutions  
and Markets Issues



Lynn H. Gibson  
Associate General Counsel  
Office of the General Counsel

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**Abbreviations**

ANPR	Advanced Notice of Proposed Rulemaking
FEMA	Federal Emergency Management Agency
OMB	Office of Management and Budget

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# Key Statutory and Executive Order Requirements Affecting Rulemaking

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Congress and the executive branch have imposed certain procedural requirements on agencies conducting rulemaking. Our review focused on the Administrative Procedure Act of 1946, the Regulatory Flexibility Act, and Executive Order 12866, which contained the requirements that were of key concern to this rulemaking. This appendix summarizes their most important features.

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## Administrative Procedure Act

The basic process by which federal agencies develop and issue regulations is spelled out by the Administrative Procedure Act of 1946.<sup>1</sup> Among other things, the act requires agencies to publish a general notice of proposed rulemaking in the Federal Register. The act requires the notice to include (1) a statement of the time, place, and nature of the public rulemaking proceedings; (2) reference to the legal authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. After the notice is published, the act requires agencies to give interested parties an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without the opportunity for oral presentation. After consideration of the relevant matter presented, the act requires agencies to incorporate in the rules adopted a concise general statement of their basis and purpose.

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## Regulatory Flexibility Act

The Regulatory Flexibility Act<sup>2</sup> requires federal agencies to examine the impact of proposed rules on small businesses, small organizations, and small governmental jurisdictions and to solicit the ideas and comments of such entities for this purpose. The act applies only to rules for which an agency publishes a notice of proposed rulemaking. Specifically, agencies must either perform a regulatory flexibility analysis describing the impact of a proposed rule on small entities or certify that the rule will not have a “significant economic impact on a substantial number of small entities.” The act does not define “significant economic impact” or “substantial number” but does prescribe guidelines for conducting the analyses required by the act.

Agencies are required to perform two regulatory flexibility analyses. First, they must perform an initial regulatory flexibility analysis at the time of publication of a proposed rule. This analysis is to describe the impact of the proposed rule on small entities. It is to include, among other things, a description of the reasons why action by the agency is being considered; a

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<sup>1</sup> 5 U.S.C. 553.

<sup>2</sup> 5 U.S.C. 601-612.

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succinct statement of the objectives of, and legal basis for, the proposed rule; and a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply. The initial regulatory flexibility analysis must also contain a description of any significant alternatives to the proposed rule that will accomplish the agency's objectives while minimizing the impact on small entities.

Second, when an agency promulgates a final rule, it must prepare a final regulatory flexibility analysis. This analysis must, among other things, respond to issues raised by public comments on the initial regulatory flexibility analysis, a description of the steps the agency has taken to minimize the impact on small entities, and a statement of the reasons for selecting the alternative adopted in the final rule and why each of the other alternatives was rejected. In preparation of both analyses required by the Regulatory Flexibility Act, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.

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## Executive Order 12866

Executive Order 12866, Regulatory Planning and Review, establishes certain principles of regulation that agencies should adhere to, such as identifying and assessing alternative forms of regulation, and tailoring their regulations to impose the least burden on society. It also prescribes processes that agencies have to follow during rulemaking. Specifically, agencies must provide the Office of Management and Budget (OMB) a list of planned regulatory actions, indicating which actions it believes are "significant regulatory actions." Significant regulatory actions are those that

- have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities;
- create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
- materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
- raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the executive order.

If an agency or OMB deems an action significant, the agency must provide OMB a description of the need for the action and how the action will meet that need, as well as an assessment of the potential costs and benefits of

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the action. For those actions in the first category, the agency must submit to OMB an assessment, including the underlying analysis, of the costs and benefits anticipated from the action and an assessment, including the underlying analysis, of the costs and benefits of potentially effective and reasonably feasible alternatives to the planned action. After a regulatory action has been published in the Federal Register, an agency must make available to the public the analyses it has done for significant regulatory actions, as well as identify for the public the difference in the draft action submitted to OMB and the announced action and the changes that were made at OMB's recommendation.

# Chronology of Major Events in the Development of FEMA's Draft Regulation

Date	Event
January 1997	FEMA's Insurance Task Force issued a report entitled "Insurance Regulations Review, Analysis, and Recommendations." Among the recommendations were suggestions on tightening the waiver requirement, requiring that grantees obtain and maintain insurance to protect against future losses, and taking action to ensure consistency among the regions in interpreting and applying insurance regulations.
March 1998	FEMA's Office of Inspector General issued a report entitled "Review of FEMA's Implementation of Insurance Requirements in the Public Assistance Program" that recommended that FEMA clarify its regulations governing the conditions under which waivers are granted.
October 1998	The Partnership for Response and Recovery, under a FEMA contract, issued a report entitled "Analysis of Public Assistance Proposed Insurance Regulation Changes" that estimated the potential cost reductions of proposed insurance regulation changes then under consideration.
November 1998	FEMA's Director James Witt stated in a speech to the National Press Club that FEMA will be proposing to condition Public Assistance grants for buildings on insurance coverage within the next 2 years.
January 1999	FEMA, working with the Public Risk Management Association, held a series of six meetings of public risk managers around the country. The Public Risk Management Association issued a final report on these meetings on February 26, 1999. The purpose of the meetings was to discuss and hear reactions to FEMA's first draft of its insurance proposal.
January 1999	FEMA initiated a study to determine the potential cost reductions to the Public Assistance Program associated with FEMA's draft insurance regulation. The study used some of the information that was the basis for the October 1998 cost reduction estimates. The study was completed in December 1999.

**Appendix II**  
**Chronology of Major Events in the Development of FEMA's Draft Regulation**

<b>Date</b>	<b>Event</b>
March 1999	FEMA and the National Emergency Management Association held a meeting in Washington, D.C., on March 16, 1999. Representatives of California, Florida, Mississippi, Louisiana, and Hawaii attended the meeting. Other meeting participants included representatives from the National Governors' Association, National Association of Counties, National League of Cities, National League of Cities Insurance Pooling Program, Public Risk Management Association, and other groups. The purpose of the meeting was to discuss and hear reactions to FEMA's Public Assistance Program insurance proposals.
March and May 1999	FEMA conducted a conference call (March 25) and met in Chicago with the National Association of Insurance Commissioners Catastrophe Work Group.
May 1999	FEMA initiated a study on the proposal's probable impact. The study was completed in December 1999.
June 1999	California Congressional Delegation sent a letter dated June 4 to the Director of FEMA requesting that FEMA slow down its rulemaking process to ensure adequate input and reflection by a broad range of parties from a policy and risk management perspective.
June 1999	FEMA held a meeting on June 9 with the National Governors' Association in Washington, D.C., to discuss and obtain reaction to its insurance proposal. In attendance were representatives from the National League of Cities, State Insurance Pooling Program, Southern Governors' Association, Council of State Governments, National Association of Towns and Townships, National Conference of State Legislators, Association of State Floodplain Managers, California Department of Education, California State Association of Counties, League of California Cities, California Hospitals, American Public Work Association, National Association of Counties, International Association of Emergency Managers, various other organizations, as well as Washington representatives of 13 governors.

**Appendix II**  
**Chronology of Major Events in the Development of FEMA's Draft Regulation**

<b>Date</b>	<b>Event</b>
June 1999	FEMA participated in a conference call with representatives of the Fresno County Board of Education, San Diego Unified, Long Beach Unified, and the Fresno Unified School districts to discuss and obtain reaction to its insurance proposal.
July 1999	FEMA submitted the draft regulation to OMB on July 2 for review and approval. FEMA designated the draft proposed rule as being economically significant under Executive Order 12866. The OMB form accompanying the submission had FEMA officials certifying that the agency complied with the requirements of Executive Order 12866 and applicable policy directives.
July 1999	FEMA met with representatives of college and university umbrella organizations to discuss and obtain reaction to its insurance proposal.
September 1999	FEMA met with the State Risk Insurance Managers Association at its annual conference to discuss and obtain reaction to its insurance proposal.
October 1999	FEMA's Director hosted a meeting with insurance executives on October 27. According to FEMA, the meeting participants agreed that FEMA's proposal had strong merit and the amount of insurance coverage appeared reasonable. FEMA also stated that there was doubt expressed about the ability of the market to provide earthquake coverage immediately and that several meeting participants suggested separating earthquake insurance from the proposal.
December 1999	FEMA contracted with PricewaterhouseCoopers to conduct various economic analyses to meet the requirements of Executive Order 12866.
January 2000	FEMA met with OMB to discuss the insurance proposal. FEMA subsequently decided to issue its insurance proposal as an advance notice of proposed rulemaking.

Source: GAO analysis of data provided by FEMA.

# Comments From the Federal Emergency Management Agency



## Federal Emergency Management Agency

Washington, D.C. 20472

FEB 7 2000

Mr. Stanley Czerwinski  
Associate Director  
Housing and Community Development Issues  
United States General Accounting Office  
441 G Street, NW, Mail Stop 2A28  
Washington, D.C. 20548

Dear Mr. Czerwinski:

This responds to your letter of February 3. You provided ten copies of your draft report on Issues Related to the Development of FEMA's Insurance Requirements, and asked for our written comments.

Overall, the draft report strikes us as a reasonable and balanced analysis. The recommendations are helpful. I expect to formalize the appointment of a Regulatory Policy Officer in short order. I have asked the General Counsel to update our regulations and guidance, governing the rulemaking process, as appropriate. While we do not expect to deal with economically significant actions in the regulatory context on a regular basis, I do feel that it is important to have the procedures in place should they be necessary.

While the draft report seemed to characterize FEMA's relationship with the Office of Management and Budget (OMB) as a hierarchical one with FEMA responding to OMB's dictates, we felt the approach was a collaborative one. During our discussions, OMB provided us with very constructive feedback that we have tried to incorporate into our proposal. For example, we had determined, based on the potential for impacts to small entities and our discussions with OMB, that we would need to do a Regulatory Flexibility Act analysis; however we have not yet determined how significant the impact on small entities would be.

I have several other comments for your consideration. On page 15 the draft report notes that over 110 public entities located in California wrote to FEMA citing various concerns about the publication of a proposed rule on insurance requirements. In listing the concerns, the draft omits the frequently expressed fear that, once published as a proposed rule, the insurance proposal would be set in stone. This was a recurrent theme, and it is entirely unfounded. We have conducted an open and collaborative process up to this point, and FEMA has every intention of continuing to take full advantage of the contributions of insurance experts and other stakeholders around the country.

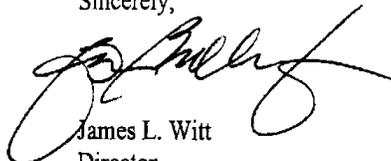
**Appendix III**  
**Comments From the Federal Emergency Management Agency**

Concerning Appendix II, the representation at the March 16, 1999, and the June 9, 1999, meeting was far broader than indicated in the chart. I recognize that you have space limitations, but suggest that you show in some fashion the wide range of groups and associations that we met with. For example, the March meeting included, in addition to the NEMA officials, representatives from the National Governors' Association, National Association of Counties, National League of Cities, National League of Cities Insurance Pooling Program, Public Risk Management Association and other groups.

The June 9 meeting was hosted by the National Governors' Association, but included guests from a wide range of concerned national, state and local organizations. In attendance were representatives from National League of Cities, National League of Cities State Insurance Pooling Program, Southern Governors' Association, Council of State Governments, National Association of Towns and Townships, National Conference of State Legislators, Association of State Floodplain Managers, California Department of Education, California State Association of Counties, League of California Cities, California Hospitals, American Public Works Association, National Association of Counties, International Association of Emergency Managers, various other organizations as well as Washington representatives of 13 Governors.

My staff has enjoyed an open and constructive working relationship with your analysis team. I believe that both the process you have employed and the report itself will benefit our ongoing insurance project, as well as our regulatory process. Thank you for the opportunity to comment on the draft report.

Sincerely,



James L. Witt  
Director

# GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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## Acknowledgments

In addition to those named above, Davi D'Agostino, Alan Belkin, Bruce Engle, Harry Medina, and James Rebbe made key contributions to this report.

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