The Changing Landscape of the National Flood Insurance Program: A Federal Perspective

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In the last few years, the National Flood Insurance Program (NFIP) has seen changes at both the legislative level as well as the implementation stage through changes to the Community Rating System (CRS). Legislatively, the program saw significant reforms with the passage of the Biggert-Waters Act of 2012 (BW-12). But the reforms of BW-12 sparked a collective outcry for revisiting those reforms with greater emphasis on affordability measures. Legislators responded with voluminous new flood insurance bills aimed at reducing the financial hit to property owners facing rising flood insurance premiums. The Mississippi Insurance Commissioner took the fight to federal court, seeking a halt to some premium increases until an affordability study could be completed. Then earlier this spring, Congress passed the Homeowners Flood Insurance Affordability Act of 2014 (aka Grimm-Waters, HFIAA). Though the HFIAA is oft touted as "repealing" Biggert-Waters, this is somewhat exaggerated. HFIAA does make significant changes to certain aspects of BW-12, however.

This paper will give a brief history of the NFIP and CRS, then discuss BW-12 impacts to flood insurance premiums, and culminate with an overview of the current state of affairs – HFIAA. Along the way, brief mention will be given to the Mississippi litigation and the 2013 changes to the CRS program.

History of the NFIP & CRS

The NFIP is a federally subsidized program created by the National Flood Insurance Act in 1968. In creating the program, Congress recognized that it was uneconomical for the private insurance industry to provide flood insurance and sought to create a nationwide program that could take advantage of "workable methods of pooling risks, minimizing costs, and distributing burdens equitably among those who will be protected by flood insurance and the general public."[1] The program was designed to "promote the public interest by providing appropriate protection against the perils of flood losses and encouraging sound land use by minimizing exposure of property to flood losses."[2]

FEMA administers the NFIP through a partnership with private insurance companies. Communities qualify to participate in the NFIP by adopting federally set minimum standards for floodplain management, often through land use regulations and building code requirements. The NFIP rewards communities that exceed the minimum standards for managing flooding risks by offering discounts on flood insurance through the Community Rating System (CRS).

Through the CRS, participating communities receive flood insurance premium reductions for floodplain management activities that exceed the minimum requirements. The CRS awards a community points for each supplemental activity it implements, as identified in the CRS manual. A community's CRS Class (1-10) depends on the number of points a community receives. For each CRS Class, a community receives a 5% reduction on flood insurance premiums in the Special Flood Hazard Area (SFHA). For example, a Class 1 community receives a 45% premium

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[1] 42 U.S.C. § 4001(d).

[2] 42 U.S.C. § 4001(c).

reduction on SFHA properties and a 10% premium reduction on non-SFHA properties, while a Class 9 community receives a 5% premium discount on premiums for both SFHA and non-SFHA properties.

In 2013, the CRS underwent significant changes as detailed in the *2013 CRS Coordinator's Manual*. The 2013 changes focus on six main flood loss reduction areas: (1) reduce liabilities to the NFIP; (2) improve disaster resiliency and sustainability of communities; (3) integrate a Whole Community approach to addressing emergency management; (4) promote natural and beneficial functions of floodplains; (5) increase understanding of risk; and (6) strengthen adoption and enforcement of disaster-resistant building codes.

Biggert-Waters Act of 2012 (BW-12)

In 2012, Congress passed BW-12 as part of a larger measure that included transportation funding and the Restore Act – a bill that sends a portion of Clean Water Act penalties from the Deepwater Horizon oil spill back to the Gulf states. BW-12 reauthorized the NFIP for five years (through 2017) and included measures designed to move the cash-strapped NFIP out of the red and into the black. The NFIP had been operating at a loss for years and BW-12 sought to adopt reforms aimed at improving the solvency of the program.

The BW-12 made three substantial changes to the flood insurance rates: (1) new policies will be issued at full-risk rates, (2) subsidies will be phased out, and (3) grandfathered rates will be phased out. Changes to new policies began last year and FEMA started phasing out subsidized flood insurance rates for vacation homes in January 2013.

On October 1, 2013, FEMA began phasing out subsidized flood insurance rates for business properties and severe repetitive loss properties that are Pre-FIRM. A property is considered Pre-FIRM if it was built before December 31, 1974 <u>or</u> before the area adopted its first Flood Insurance Rate Map (FIRM). These properties have, until now, received a subsidized rate. Rates will now increase by 25% per year until the full-risk rate is realized.

Pre-FIRM primary residences receiving subsidized rates will continue to qualify for the subsidies until: (1) the property is sold, (2) the policy lapses, (3) the property suffers severe, repetitive flood loss, or (4) a new policy is purchased. A property qualifies as a primary residence if the insured or their spouse resides there for 80% of the year. However, once a Pre-FIRM primary residence loses its subsidized rate, the rate will immediately increase to the full risk rate. Nationwide, approximately 20% of flood insurance policies are subsidized.

As BW-12 implementation got underway, stories of extreme rate hikes for select properties began to surface. Public outcry and calls for reform quickly followed. Numerous proposals to reform BW-12 were introduced in Congress and the State of Mississippi filed a federal lawsuit seeking to halt the implementation.[3] The reform efforts finally culminated with the passage of the Homeowner Flood Insurance Affordability Act of 2014.

Mississippi Litigation

Days before significant changes to domestic flood insurance took effect, the Mississippi Insurance Commissioner filed suit against the U.S. Department of Homeland Security and the Federal Emergency Management Agency (collectively referred to as FEMA) essentially seeking to halt rate increases mandated by BW-12. Mississippi's lawsuit was eventually joined by Florida, Alabama, Massachusetts, South Carolina, Louisiana, a local Mississippi county, and the

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[3] Niki Pace, *Can Miss. Hold Back the Flood Insurance Rate Hikes*, Law360, NEW YORK (Dec. 19, 2013, 6:36 PM), http://www.law360.com/articles/495638/can-miss-hold-back-the-flood-insurance-rate-hikes-.

Mississippi Windstorm Underwriting Association. At issue was whether the economic impacts and affordability of these reforms should have been taken into account prior to initiating the rate changes.

Through this litigation, the Mississippi Insurance Department (MID) sought to stop flood insurance rate hikes brought on by BW-12, what MID characterizes as "an oncoming economic disaster to Mississippi citizens" and others living in the flood zone.[4] In simple terms, MID argued that BW-12 required FEMA to conduct studies, including an affordability study, before instituting the rate changes also required by BW-12. As noted by amici briefs, BW-12 imposed set deadlines for study completions but gave FEMA more timeline flexibility for initiating some of the rate changes. The studies, due to Congress 270 days after passage of the Act (April 2013), were incomplete. For that reason, MID requested the court stop FEMA from carrying out flood insurance rate increases until the studies were done. FEMA, not surprisingly, disputed this interpretation of BW-12, maintaining that the rate changes and the studies are two parallel requirements imposing independent obligations on the agency. Hearings were held in December 2013 but no ruling was issued in hopes that Congressional action would moot the litigation, as happened with the passage of HFIAA.

Homeowner Flood Insurance Affordability Act

Earlier this spring, Congress passed the Homeowners Flood Insurance Affordability Act of 2014 which was signed into law by President Obama on March 21, 2014. The HFIAA, also referred to as Grimm-Waters for its Congressional sponsors, alters several provisions of the 2012 flood insurance program reforms adopted as part of BW-12. The Biggert-Waters Act had made significant changes to the National Flood Insurance Program (NFIP) in efforts to improve the programs financial stability. Those changes included raising rates to full actuarial rates over a five-year period, phasing out subsidies on some properties, and eliminating grandfathered rates over five years.

Upon its passage, many touted the HFIAA as repealing the Biggert-Waters NFIP reforms but this is not entirely accurate. Coastal property owners should be aware that while HFIAA did make significant changes, it did not repeal all aspects of BW-12. Key changes of interest include reforms to new home sales, primary residences, and grandfathering. Under HFIAA, flood insurance rate increases on primary residences are capped at 18% per year. As to grandfathering, properties that are newly mapped into a different flood zone will be allowed to keep their lower rate the first year and subsequent rate increases are generally capped at 18% per year. And buyers of new home sales will no longer see their flood insurance rates jump to full actuarial risk. HFIAA allows home sellers to transfer their insurance rate to the new buyer. However, those rates may still increase up to 18% per year if the rate was subsidized.

The HFIAA did not change premium increases established under Biggert-Waters for certain classes of properties. Flood insurance rates will continue to increase by 25% per year for the following: (1) vacation homes, (2) businesses, (3) severe repetitive loss properties, and (4) pre-FIRM buildings that have been substantially damaged or improved. Pre-FIRM refers to buildings constructed before December 31, 1974 or before the community's first flood insurance rate map (FIRM) was adopted. HFIAA also added a surcharge to all flood insurance policies that will remain in effect until all pre-FIRM subsidies are eliminated. The surcharge is $25 annual for primary residences and $250 for all other properties. The HFIAA included numerous other

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[4] First Amended Complaint, Miss. Insurance Dept. v. U.S. Dept. of Homeland Security, 1:13cv379, filed Oct. 7, 2013, at ¶ 4.

provisions related to mapping, the affordability study commissioned under Biggert-Waters, and efforts to improve community understanding of the flood insurance mapping process.

<u>**RECAP:**</u>

- **Recent Changes to NFIP**
    - Biggert-Waters Act 2012
    - 2013 CRS Coordinators Manual
    - Homeowners Flood Insurance Affordability Act 2014

- **Biggert-Waters Act**
    - Reauthorized NFIP for 5 years (2017)
    - Phased out <u>subsides</u> for:
        - Non-primary residences (vacation homes)
        - Business properties
        - Severe repetitive loss properties
    - New policies at full-risk rates
    - <u>Grandfathered</u> rates phased out over 5 years

- **Subsidies v Grandfathering**
    - **Subsidies:**
        - Pre-Firm:
            - built before Dec. 31, 1974 or the communities first flood insurance rate map became effective **AND**
            - Has not been substantially damaged or improved.
        - Received discounted rate under NFIP
        - BW-12 phased this out at 25% annually

    - **Grandfathering:**
        - Properties that are built compliant to their flood zone at the time of construction.
        - These properties had been grandfathered in under a new map change (ie, treated as if they had built to the current flood zone for rate purposes)
        - BW-12 would have phased this out over 5 years.

- **Homeowners Flood Insurance Affordability Act of 2014**
    - **Primary Residences**
        - Rate increases reduced to 18% per year.

    - **Grandfathering**

    - Newly mapped in properties to keep lower rate first year.
    - Rate increases generally capped at 18% per year.

- **Home Sales**
    - No longer at full actuarial rate, can transfer rate to new owner.
    - Rates may still increase at 18% per year if the property was receiving a subsided rate.

- **Does Not Change (same as under BW-12):**
    - Premium increases for:
        - Vacation homes
        - Businesses
        - Severe repetitive loss properties
        - Pre-FIRM buildings that have been substantially damaged or improved.
    - Those premiums continue to increase by 25% annually.

- **Surcharge Added:**
    - $25 annually for primary residences
    - $250 for all others
    - Applies to <u>all</u> policies until Pre-FIRM subsidies are eliminated.

- **Affordability Framework**
    - Increased funding from $750,000 to $3 million
    - Must consider:
        - Accurate communication to customers of the flood risk;
        - Targeted assistance based on financial ability to pay;
        - Individual and community actions to mitigate flood risk or lower cost of flood insurance;
        - The impact of increases in premium rates on participation in NFIP; and
        - The impact of mapping update on affordability of flood insurance.
    - Includes proposals and proposed regulations for ensuring flood insurance affordability among low-income populations.

- **Mapping**
    - Must consider the effects <u>of non-structural flood control features, such as dunes, and beach and wetland restoration</u> when it maps the special flood hazard area.
    - Consider the existing <u>present value of a levee</u> when assessing adequate progress for the reconstruction of an existing flood protection system.
    - Extends certain provisions related to NFIP requirements in <u>areas restoring disaccredited flood protection systems to coastal levees</u> and <u>clarifies that the levee needs to be considered without regard to the level of federal funding</u> for the original construction or the restoration.

- **Improved Community Understanding**
  - During Mapping:
    - Must enhance coordination with communities before and during mapping activities and
    - Report certain information to members of Congress for each State and congressional district affected by preliminary maps.

- **Flood Insurance Advocate**
  - Advocate for fair treatment of policyholders.
  - Advocate will educate policyholders:
    - On flood risks, flood mitigation, map process, changes in flood insurance laws;
    - The procedural requirements related to appealing preliminary flood insurance rate maps;
    - Coordinate outreach and education with local officials and community leaders;
    - Assist with regional capacity to respond to constituents concerns re new maps

Sea Grant Mississippi-Alabama Legal Program

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