Dear Mr. Connor:

The Association of State Floodplain Managers (ASFPM) has developed the attached white paper regarding FEMA's flood insurance rating method for properties affected by flood map changes—Administrative Grandfathering. This white paper does not address a similar subject, the subsidized rates for Pre-FIRM structures that are “grandfathered in” if the structures are built before January 1, 1975 or before the community’s first FIRM became effective. The attached white paper was recently adopted by the ASFPM Board of Directors.

Currently, the Federal Emergency Management Agency (FEMA) is in the process of undertaking a systematic evaluation of the NFIP. ASFPM has previously stated its support of FEMA’s efforts in this endeavor. The attached white paper summarizes several concerns with the current “Administrative Grandfathering” rating method and offers recommendations on how they might be addressed.

We ask that FEMA review the concerns and consider the recommendations in the white paper as part of the evaluation of the NFIP. Since we share a common goal of reducing damages and risk from natural disasters, ASFPM pledges its continued assistance in shaping a more effective NFIP. If you have suggestions on ways that ASFPM can assist FEMA in this endeavor, please do not hesitate to contact me.

Sincerely,

Greg Main, CFM, ASFPM Chair

CC: FEMA—Sandra Knight, James Walke, Mike Grimm
ASFPM- Larry Larson, Chad Berginnis, Bruce Bender, Gary Heinrichs

Edward Connor
Acting Mitigation Division Director
FEMA/DHS
500 C Street, SW, Room 406
Washington, DC 20472

October 11, 2010
Administrative Grandfathering

An Important Rating Method Needing Revision

This is a position paper prepared by the Association of State Floodplain Managers, (ASFPM), a non-profit professional organization dedicated to reducing flood losses and protecting floodplain functions and resources in the United States.

Subsidized flood insurance and its effects on the financial solvency of the National Flood Insurance Program (NFIP) has been an issue that has received a lot of attention in the past few years. The focus on ways to improve the NFIP’s financial state became significant when Hurricanes Katrina, Rita and Wilma resulted in a large number of claims to the NFIP and put the program over $17 billion in the red.

This is a white paper about administrative grandfathering which is a flood insurance rating method available through the National Flood Insurance Program for properties affected by flood map changes. This paper is prepared by the Association of State Floodplain Managers (ASFPM), a non-profit professional organization dedicated to reduction of flood losses.

This paper does not address a similar subject, the subsidized rates for Pre-FIRM (Flood Insurance Rate Map) structures that are “grandfathered in” if the structures are built before January 1, 1975 or before the community’s first FIRM became effective.

BACKGROUND

The National Flood Insurance Program (NFIP) Grandfathering rule has been used by the Federal Emergency Management Agency (FEMA) since the latter part of 1974. It evolved as an administrative interpretation after Congress passed the National Flood Insurance Act of 1974. This rule allowed NFIP policyholders to retain a more favorable premium when a map revision occurred, which might have otherwise caused higher premiums for the policyholder at renewal.

Administrative grandfathering (discussed as “grandfathering” in this paper) is a unique aspect of the flood insurance program. In traditional property insurance, a building’s premium is based upon its current risk, and not using rates based on its condition, level of risk, etc. from years ago. With the NFIP, if a property owner built a home or commercial structure before a community joined the NFIP or to at least the minimum standards adopted by an NFIP participating community at the time of construction, FEMA felt that the property owner should not be penalized if a new Flood Insurance Rate Map (FIRM) resulted in the property being mapped into a higher risk zone or higher Base Flood Elevation (BFE).
How Grandfathering Works

The Grandfathering rule allows FEMA to recognize policyholders who have built in compliance with the FIRM that was in effect when the structure was built, and/or who have maintained continuous coverage from before the map change and through after the new FIRM becomes effective. Policyholders are given two options and can use the one that gives them the more favorable premium:

1) use the rating criteria for their building based on the new maps, or

2) use the rates based on the flood zone and/or the Base Flood Elevation (BFE) from the FIRM that was in effect when it was built or the FIRM in effect when the policy was first purchased, which could beneficially affect the rating.

The conditions that must be met to be eligible for grandfathering are:

1) the building must have been built in compliance with the FIRM that was in effect at the time of construction (note: if there was no FIRM in effect at the time of construction, the building is not eligible to use this form of grandfathering); or

2) for those using the continuous coverage option, the building has not been altered in any way that has caused the lowest floor, for rating purposes, to be lower than the BFE on the FIRM that was in effect when the building was originally constructed, or the FIRM that was in effect when the flood insurance policy was first obtained.

Examples of Grandfathering

The benefits of lower premiums through grandfathering have become very visible during the past few years as the nation’s flood hazard maps are updated through FEMA’s Flood Map Modernization (Map Mod) and now their Risk MAP effort. Increased development in watersheds, new technology, improved data and new modeling and mapping techniques have resulted in changes in flood boundaries and Base Flood Elevations.

When high-risk flood areas (known as Special Flood Hazard Areas or SFHAs) are expanded or Base Flood Elevations are increased due to a remapping, the flood insurance premiums for the affected properties typically increase when the new FIRMs became effective. The premium differences can be significant; but, grandfathering lessens that difference by allowing the policyholder to lock in the flood zone or BFE and use the respective rates to calculate premiums at each subsequent renewal (there is often a misunderstanding that the insured gets to keep the same rate for future calculations; instead they keep the same flood zone or BFE). The two examples below illustrate those differences.
Grandfathering: Continuous Coverage Option

**GRANDFATHERING PREMIUM EXAMPLE: CONTINUOUS COVERAGE OPTION***

<table>
<thead>
<tr>
<th>Zone Pre-FIRM Premium</th>
<th>Post-FIRM Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIRM In Effect When Built</td>
<td><strong>X</strong></td>
</tr>
<tr>
<td>New FIRM</td>
<td>AE</td>
</tr>
</tbody>
</table>

Difference in Premium if Not Grandfathered

<table>
<thead>
<tr>
<th>Zone</th>
<th>Pre-FIRM Premium</th>
<th>Post-FIRM Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+$1,829</td>
<td>+$1,095</td>
</tr>
</tbody>
</table>

*Assumes coverage for $200,000 building (no basement)/$80,000 contents; includes Federal Policy Fee and Increased Cost of Compliance; May 2010 rates

**These are Preferred Risk Policy (PRP) premiums that apply for the first year. When the policy first renews after the new FIRMs become effective, it must be renewed using the standard rate for whatever zone the property is in, in this case the X zone rates. The premium in this example would become $1,307 (assuming no rate increases).

***This example assumes the building’s Lowest Floor Elevation is equal to the Base Flood Elevation.

In this Continuous Coverage Option example, if the Pre-FIRM property owner had a mortgage through a federally regulated or insured lender, the property owner would be required to purchase flood insurance when the new maps became effective and would have to pay $2,162. If you looked at it from a longer period of time, let’s say over three years, the cost would total $6,486 (for discussion sake, this assumes no rate increases). If they bought a Preferred Risk Policy before the new maps became effective, they would pay just $333 that first year and then $1,307 at the first renewal and the same at the second renewal. Looking at the cost impact over three years, it would only be $2,947 (again, assuming no rate increases) with a savings of $3,539 for the pre-FIRM property due to grandfathering. For the Post-FIRM property example, grandfathering would provide a 3-year savings of $1,095.

Grandfathering: Built in Compliance Option

**GRANDFATHERING PREMIUM EXAMPLE: COMPLIANCE OPTION***

<table>
<thead>
<tr>
<th>Lowest Floor Elevation Above Base Flood Elevation</th>
<th>Post-FIRM Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIRM When Built +2 feet</td>
<td>$547</td>
</tr>
<tr>
<td>New FIRM (BFE increases 3 feet) -1 feet</td>
<td>$5,614</td>
</tr>
</tbody>
</table>

Difference in Premium if not Grandfathered

<table>
<thead>
<tr>
<th>Zone</th>
<th>Post-FIRM Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+$5,067</td>
</tr>
</tbody>
</table>

*Assumes coverage for $200,000 Post-FIRM building (no basement)/$80,000 contents in an AE zone; includes Federal Policy Fee and Increased Cost of Compliance; May 2010 rates

In this Compliance Option example, the property owner initially constructed the building two feet above the minimum required elevation. Due to any number of factors including significant development in the watershed, subsidence over time, or more current flood elevations due to updated hydrology and hydraulics, the BFE increased by three feet when the new flood maps were published. This put the Lowest Floor Elevation one foot below the new BFE, which reflects the current flood risk to the property. Yet the property owner built it correctly per the code in effect at the time of construction. If the grandfathering rule was not available, the property owner would pay about ten times as much for their premium. In three years, that difference would be over $15,000.
UNDERSTANDING THE ISSUES

Early Concerns

The concern about the effects of grandfathering on the actuarial soundness and financial viability of the program is not new. A January 1995 audit report from FEMA’s Office of Inspector General (OIG) found that the Federal Insurance Administration (FIA) did not have a good system in place to confirm that the grandfathering was properly calculated. OIG recommended that the FIA evaluate what would happen if grandfathering was eliminated, “and if possible, begin phasing it out.” They also recommended that the FIA create a better system to verify the accuracy of rating. Evidently, the FIA acknowledged this, but there were no changes regarding grandfathering implemented in the 15 years since (except for the recent requirement for new policies to indicate on the declaration page that it is grandfathered).

Effect on Actuarial Soundness

When FEMA solicited input about the NFIP in September 1998 through their Call for Issues, they received several responses for changing or eliminating grandfathering. When the report was issued in June 2000, FEMA’s response was that they would study it further. Grandfathering was then included in two studies that were part of the American Institutes of Research’s Evaluation of the National Flood Insurance Program study [2001-2006]. The two studies (The Role of Actuarial Soundness in the National Flood Insurance Program [October 2006] and The National Flood Insurance Program’s Mandatory Purchase Requirement: Polices, Processes and Stakeholders [March 2005]) both recognized that an increase in grandfathered properties could result in a shortfall of premium to the Program. They also noted that the NFIP does not currently capture if grandfathering was used by the insurance agent for rating. Consequently, since there is no means at this time for FEMA to track how many properties are being grandfathered (and their respective premium and claims information), there will be no way to determine what that financial effect is and will be as the number of grandfathered policies increases due to FEMA’s Flood Map Modernization effort and its subsequent Risk MAP program. On October 1, 2009 FEMA did start requiring that at least all new applications capture additional information if it is being grandfathered and note it as a grandfathered policy on the declaration page. That still leaves a universe of undocumented grandfathered policies.

While FEMA currently has no way to identify how many policies have been rated with grandfathered BFEs or grandfathered zones, The Role of Actuarial Soundness study does estimate that the number to be small (e.g. 0.3% for grandfathered BFEs, 1-5% for grandfathered zones). As just mentioned though, this number of non-actuarially rated policies will increase significantly as the nation’s floodplains are re-mapped to better identify the true flood risk in communities. The “Soundness” study was done when Map Mod was just starting, so its impact was not known. This aforementioned study and the October 2007 GAO Report, Ongoing Challenges Facing the National Flood Insurance Program, both point out then the difficulty FEMA has in balancing policy growth with “actuarially soundness and financial stability of the Program.” The Actuarial Soundness study did comment that removing grandfathering would have a negative effect on not only attracting new policyholders, but retaining current ones as well.

Effect on Map Adoption

Besides providing subsidized beneficial rates for those property owners being affected by a remapping, another area that the NFIP grandfathering rule can have an influence is on map adoption at the local
level. When flood map revisions result in significant increases in flood insurance premiums, adversely impacted residents of local communities can become more resistive to supporting the adoption of the maps. This could result in a lengthened timeframe in adopting the maps and therefore allow for additional new construction to be built in harm’s way by relying on the previous flood map. In addition, grandfathering can be a “good news” story. By local officials promoting the fact that the property owners are at risk now and not to wait until the new flood maps become effective, this could result in property owners becoming protected earlier than later.

Effect on Risk Awareness

Grandfathering, unfortunately, can also result in a false sense of security and a reduced awareness of the true flood risk. This reduced awareness can result in the home or business owner being less likely to perform mitigation to reduce the level of risk due to flooding; e.g., elevate, install flood vents, floodproof. The Heinz Center’s April 2000 report, *Evaluation of Erosion Hazards*, provides an example on how grandfathering can result in an increase in potential damage. In their example, an “A” zone property was newly mapped into a “VE” zone, but is not required to elevate to the true BFE or pay actuarial premiums for flood insurance. Consequently, it has a greater chance of being damaged compared to a building originally built in the “VE” zone, essentially across the street. Coastal communities will experience an increase in this scenario as FEMA begins to focus more on coastal mapping as Flood Map Modernization winds down and Risk MAP strategy commences. The same thing happens in riverine communities throughout the nation. Where a levee is de-accredited, and all structures in the “protected” area behind the levee are required to buy flood insurance, communities heavily urge property owners to buy the flood insurance before the de-accredited levee map becomes effective so they can obtain the reduced premium.

**RECOMMENDATIONS**

The following are four major recommendations that ASFPM has regarding the grandfathering of insurance policies.

**Collect and Track Grandfathering Information**

FEMA has begun capturing if a property is being grandfather-rated but only for newly grandfathered properties. So, overall, there is still no way to track how many flood insurance policies are currently grandfathered. Consequently, FEMA cannot quantify what the effects of grandfathering are on premium and losses, let alone the financially stability of the Program. This concern was also illuminated in the GAO Testimony to Congress in April 2010 (*Continued Actions Needed to Address Financial and Operational Issues*). FEMA cannot afford to wait until another large loss or catastrophe occurs to learn what the extent of the grandfathering effect is.

*Recommendation: For new and existing flood insurance policies and their renewals, FEMA should collect and track information to show if the policy is grandfather-rated.*

**Unmask the Risk**

Making the NFIP an actuarially sound program is a significant challenge for FEMA. When map changes occur, the grandfathering option provides an attractive selling point and supports FEMA in making flood insurance available and affordable. Unfortunately, it masks what the real flood risk is to the property
owner and creates higher risks for them as losses occur, which in turn will affect even more the actuarially soundness and financial stability of the program.

**Recommendation:** FEMA’s grandfathering of flood insurance rates is an important feature of the NFIP. Grandfathered rates should move towards actuarial rates so that eventually the subsidy is eliminated.

**Recommendation:** FEMA should include a notice with each policy that advises the policyholder that they are at a greater risk of flooding than their policy is rated and that they may wish to take some mitigation action to reduce that risk.

Better Education

Many lenders, claims adjusters and even insurance agents do not fully understand how grandfathering works or even what it is. This lack of knowledge or misunderstanding about grandfathering can lead to problems for a policyholder when a lender is trying to resolve a flood zone discrepancy, a claims adjuster is adjusting a claim, or an insurance agent is providing the best option.

**Recommendation:** FEMA should provide on their web sites (including FloodSmart.gov and Agents.FloodSmart.gov) more information about grandfathering specific to each of the audiences. Also FEMA should provide a training module on the NFIP Training web site and offer Webinar-based training about the effects of Map Changes on Insurance that includes grandfathering.

**SOURCES**


