



## ASSOCIATION OF STATE FLOODPLAIN MANAGERS, INC.

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### A Vision for Implementing ICC as it Exists in Law Today

FEMA can make needed improvements to the Increased Cost of Compliance (ICC) coverage under current law. ICC changes are vital to effectively mitigate and provide future savings to the National Flood Insurance Program (NFIP). This paper is the first of two efforts by ASFPM to promote more effective use of ICC. This paper discusses how ICC might look today if implemented consistent with current law and Congressional intent. Recommendations contained in this paper do not require changes in statute. The second effort will be an ASFPM white paper to look into future changes in ICC that may require new or modified statutory authority. The ICC white paper should be finished later in 2016.

#### Current State of ICC

Since inception in 1997 through 2014, ICC has:

- Settled 30,042 claims paying \$669,362,511 in paid losses, with an average claim payment of \$21,682
- Averaged 1,669 claims annually, with the highest 10-year average (2003-2012) being 2,814.
- Collected \$1,342,200,158 in earned premium, paid \$429,504,051 in underwriting expenses (32%), paid \$53,549,001 in LAE (8%), and paid \$669,362,511 in claims (50%), leaving a balance of \$189,784,595.

#### Triggers

Under Section 1304(b), there are four triggers for ICC:

1. Repetitive loss properties
2. Substantial damage
3. Properties for which the Administrator determines ICC is cost effective and in the best interest of the NFIP
4. Upon an offer of mitigation through FEMA's HMA programs and "any program authorized or for which funds are appropriated to address any unmet needs or for which supplemental funds are made available."

As ICC is being implemented today, effectively only trigger #2 is used. Trigger #4 was added during the 2004 Reform Act. Today, there are tens of thousands of repetitive loss properties in the NFIP that, if mitigated, could reduce future claims to the program. Also, based on FEMA data, from 2005-2014, an average of 2,160 properties were mitigated annually against flood through FEMA's HMA programs<sup>1</sup>. By fully implementing triggers #1, #3, and #4, a significant number of properties would be added that would be eligible for ICC.

**FEMA should implement triggers #1, #2, and #4 now.**

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<sup>1</sup> Based on data tabulated by Jody Springer, FEMA, in October, 2015. Number includes FMA, HMGP, PDM as well as older programs such as RFC and SRL. Mitigation types that were included are acquisition, elevation, floodproofing and relocation.



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Trigger #1 may be the most problematic to implement fully due to the sheer number of repetitive loss properties. However, FEMA could identify a subset such as severe repetitive loss properties to first allow ICC to be used in conjunction with. Trigger #1 should not be tied in any way to substantial damage determinations or cumulative substantial damage language in a community's ordinance.

Trigger #2, should be implemented when substantial damage occurs modified to include damage resulting from any hazard including fire and earthquake. Cumulative SD and SD based on a percentage other than 50% are already in law but are not uniformly implemented and allowed.

Trigger #3 is more complex to implement without changes to the surcharges and policy development, so it could be done at a later time.

Trigger #4 should be implemented without precondition of substantial damage for all HMA programs and other post-disaster program such as CDBG-DR. If it is used in conjunction with FMA or PDM, the FMA rules governing when a flood insurance must have been obtained/maintained could be used prevail. Any offer of mitigation through a program other than FEMA's HMA programs, must demonstrate cost-effectiveness using FEMA's benefit-cost tool or other technique substantially similar.

### Coverage & Limits

**ICC claims cap should be raised to \$60,000 - \$75,000. FEMA could also introduce the concept of co-insurance for any amount of ICC over a base of \$30,000.** FEMA could use the following formula:

- Up to \$30,000, 100% ICC funded
- From 30,000 to 60,000 or 75,000, ICC funds 75%, insured pays 25% (co-insurance)

A co-insurance concept would provide less ICC funding for the policyholder compared to raising the cap. However it would also incentivize cost control by the insured (since the property owner has a vested interest to get the best estimate), and stretch ICC funding. In the accompanying spreadsheet, ASFPM also calculated scenarios for ICC being raised to \$75,000.

**ICC caps should be in addition to the coverage limits under the NFIP SFIP.** As currently interpreted by FEMA, an ICC claim plus any damage claim in aggregate cannot exceed maximum coverage limits based on the general limitations of insurance coverage found in Section 4013. However, we would argue that 42 USC Section 4013 does not apply to ICC as there is no direct statutory reference to the additional coverage authorized in Section 4011. We note that ICC is authorized under 4011(b) and includes its own authorized rate – a surcharge – within that same section of law. At a minimum, ASFPM requests that FEMA's general council provide a written interpretation justifying why ICC is considered part of the maximum coverage limits.

**A structure with an ICC claim should not have to be in an identified SFHA.** Only one of the four triggers is based on the supposition that a property is in the SFHA – ones that are substantially damaged. However, as currently implemented essentially any ICC claim has to be for a structure located in the SFHA. This is not consistent with the law.



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**Eligible costs under ICC should be no more restrictive than those under a FEMA HMA grant for that particular mitigation activity.** FEMA has continued to use a strict and literal interpretation of the statute pre-2004 as well as restrictions in the Standard Flood Insurance Policy (SFIP - which should not supersede the intent of the ICC statutes) to limit severely the amount available for acquisitions, contending that only a portion of the work is required for “compliance,” i.e., demolition of the building. Acquisition costs that are eligible for ICC must be expanded to cover 1) the costs associated with purchasing the property when an assignment of claim is made to a community (and appropriate deed restrictions are in place), and 2) all elements of demolition that are required by the FEMA grant programs in order to return a lot to open space., should be eligible.

This is especially important under trigger #4 to ensure consistency with the HMA grant programs. This includes:

- Providing pre-flood market value of the building and structure to the property owner for the purposes of acquiring the structure and land in addition to physical relocation and/or demolition costs. This would put actions that totally eliminate the risk of flooding (acquisition) on equal footing with other flood mitigation alternatives
- Demolition of all improvements left on existing property necessary to return the property to green space, including restoring vegetation for acquisition projects
- New construction costs under mitigation reconstruction alternative are allowed
- Elevation to the FFRMS standard if higher than locally required standards (permissive but not required unless ICC is used in conjunction with other federally funded mitigation grant programs).

Prior to 2004, ICC was defined in statute to cover the cost of implementing activities compliant with community land use and control measures. In getting the consistent with language into statute in 2004, ASFPM wanted the program to acknowledge local mitigation planning efforts, community acquisition programs to reduce flood risk, and other community activities that result in a prioritization of a number of hazard mitigation activities. For more than a decade, ASFPM has been arguing that using ICC, for example, to pay for the acquisition of a structure that was being acquired under a HMA grant should not only be eligible, but the full cost of acquisition up to the ICC cap should be provided to cover acquisition costs in addition to the narrowly defined demolition costs historically eligible.

Ultimately the higher caps and the greater ability for ICC to result in full mitigation for a structure without needing a post-disaster mitigation grant could reduce overall disaster costs and make existing funds go further . For example, flood insurance claims payments for damages would still be considered duplication of benefits as it typically would in a HMA project; however, given that ICC would now make it more feasible to acquire the building quickly, overall costs savings would be higher / mitigation funds would go further, because a proper use of claim funds is to repair a structure that might later be acquired using taxpayer funded PDM or HMGP programs.

### Pricing & Cost

**ASFPM recommends an updated rating structure that increases all rates, but especially lower risk properties which would benefit from the other changes in ICC which are being proposed.** This recognizes the unidentified



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risks to all properties including areas where FEMA has not mapped (and properties are receiving the benefits of a low-cost policy) and the fact that flood risk changes – and usually increases – over time.

The overall approach for pricing ICC has been virtually unchanged (other than the amounts) through the history of the coverage – essentially a token rate (as low as \$4) is set for Zone B,C, X properties while the highest amounts are for Pre-FIRM subsidized properties in A or V zones (currently maximum \$70). This approach made sense when ICC statutorily tied primarily to substantial damage, and the cost of compliance. However, the 2004 reforms did two important things fundamentally change the intent of ICC – triggering ICC upon an offer of mitigation (where there was no prerequisite of damage) and eliminate the word “compliance” in statute and instead substitute the phrase “consistent with.” Regardless of how it has been interpreted since 2004, ICC in statute is not dependent on substantial damage and hence required compliance and should have other considerations taken into account for pricing. For example, by triggering ICC by virtue of a property being a repetitive loss or upon an offer of mitigation is not dependent on being in an A-Zone where compliance is required. Further, due to the incompleteness of mapping in the nation (1.1 million miles mapped of 3.5 million miles as well as little to no stormwater inundation mapping or residual risk mapping), many structures can obtain low-cost properties. Implementing triggers associated with repetitive loss and offers of mitigation are reflective of such a reality.

The bottom line is that the more expansive use of the four triggers should logically result in the low and medium risk policies to pay a larger share of ICC than they traditionally have. The accompanying scenario spreadsheet examines 10 different scenarios, up to a flat \$75 fee per policy (which would generate \$375,000,000/year based on 5 million policies), using a simplified three tiered pricing approach: A99, B, C, X Zone; Pre/Post FIRM Full Risk Rating; and Pre-FIRM Subsidized Rating

On the income side, the statutory authority for ICC allows for the imposition of a surcharge on each insured policy of not more than \$75 per policy, without further instruction on its basis (actuarially based, etc. On the expense side, one of the more disturbing aspects of ICC is the amount of funding for U/W + LAE. Historically it has been 40% of premium collected, resulting in a total ICC cost of \$483,053,052 since program inception in 1997. With 30,042 ICC claims during that same time period, the cost, per ICC claim is \$16,079. ASFPM questions why these costs are so high and given the level of effort to settle an ICC claim, it would seem that \$10,000 per claim would be more than reasonable (\$30,000,000 per year based on 3,000 claims). Certainly, with the increased cap for ICC, WYOs shouldn't see their fees exceed what they have received historically from a constant dollar perspective (\$16,079) per claim.

Of course the fundamental question becomes when you activate the other ICC triggers, how many more claims and expenses to the program will we see? ASFPM performed several scenario calculations up to an average of 5,000 full ICC claims annually. Since inception which includes Katrina and Sandy through 2014, ICC has averaged 1,669 claims per year. Another way to look at ICC claims is to look at the highest 10 year average which would be from 2003 to 2013 which results in an average of 2,814 claims per year. Based on our calculations, it is possible, under the current ICC surcharge cap, to increase the ICC claims to an average of 5,000 per year which would allow implementation of triggers #1, #2, and #4.



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### APPENDIX A. Statutory Authority for ICC -- 42 USC Section 4011(b)

#### **(b) Additional coverage for compliance with land use and control measures.**

The national flood insurance program established pursuant to subsection (a) shall enable the purchase of insurance to cover the cost of implementing measures that are consistent with land use and control measures established by the community under section 1361 [42 USCS § 4102] for--

(1) properties that are repetitive loss structures;

(2) properties that are substantially damaged structures;

(3) properties that have sustained flood damage on multiple occasions, if the Administrator determines that it is cost-effective and in the best interests of the National Flood Insurance Fund to require the implementation of such measures; and compliance with the land use and control measures.

(4) properties for which an offer of mitigation assistance is made under—

(A) section 1366 [42 USCS § 4104c] (Flood Mitigation Assistance Program);

(B) the Hazard Mitigation Grant Program authorized under section 404 of the Robert T. Stafford Disaster Assistance and Emergency Relief Act (42 U.S.C. 5170c);

(C) the Predisaster Hazard Mitigation Program under section 203 of the Robert T. Stafford Disaster Assistance and Emergency Relief Act (42 U.S.C. 5133); and

(D) any programs authorized or for which funds are appropriated to address any unmet needs or for which supplemental funds are made available.

(E) [Redesignated]