May 30, 2024

To: Kelly Bronowicz, Product and Policy Development Division Director, Federal Insurance Directorate, Resilience, Federal Emergency Management Agency

Re: National Flood Insurance Program: Standard Flood Insurance Policy, Homeowner Flood Form, 89 Fed. Reg. 8282 (Feb. 6, 2024) (Docket No. FEMA-2024-0004)

The Institute for Policy Integrity at New York University School of Law (Policy Integrity)[1] respectfully submits the following comments to the Federal Emergency Management Agency (FEMA) regarding its proposed rule to amend the Standard Flood Insurance Policy and Homeowner Flood Form under the National Flood Insurance Program (NFIP) (collectively, the Proposed Rule).[2] Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

The proposed amendments reflect sensible steps to simplify the form and provide flexibility in coverage. We suggest the following improvements to FEMA's proposal and underlying analysis.

FEMA should take additional steps to reduce flood losses through preventative measures:

- **FEMA should provide homeowners with advance payments for loss prevention measures**. In order to make it easier for homeowners, particularly lower-income homeowners, to take preventative measures ahead of a flood, FEMA should provide an advance payment for covered measures.
- To increase uptake of resilience measures, **the declarations page should explain how adaptive behaviors affect a homeowner's premium and how climate change may increase flooding risk.**

FEMA should revise its regulatory impact analysis (RIA) to conform to best practices under Circular A-4, which is the Office of Management and Budget's principal guidance on cost-benefit analysis:[3]

- FEMA should **update its baseline to reflect the increased frequency and magnitude of flooding due to climate change** and assess how the changing baseline affects the costs and benefits of its proposed changes to the Standard Flood Insurance Policy**.**
- FEMA should **conduct a distributional analysis of the effects of the Proposed Rule.**

[1] This document does not purport to present the views of New York University School of Law, if any.

[2] National Flood Insurance Program: Standard Flood Insurance Policy, Homeowner Flood Form, 89 Fed. Reg. 8282 (proposed Feb. 6, 2024) (to be codified at 44 C.F.R. 61) [hereinafter "Proposed Rule"].

[3] *See*, *e.g.*, OFF. OF MGMT. & BUDGET, CIRCULAR A-4: REGULATORY ANALYSIS (2023) [hereinafter CIRCULAR A-4].

FEMA should make minor revisions to the Homeowner Flood Form to provide policyholders with greater clarity:

- In order to improve uptake of the endorsements and to reduce confusion, **the Homeowner Flood Form should contain cross-references to the endorsements where the terms of the endorsements conflict with the terms of the general policy.**

Background

In 1968, Congress passed the National Flood Insurance Act, creating a federally-funded flood insurance program.[4] Homes and businesses may purchase policies from the National Flood Insurance Program (NFIP), provided they are located in communities meeting certain minimal floodplain management standards.[5] Congress requires that homes and businesses in certain flood risk areas have flood insurance as a condition of receiving federally-backed mortgages or grants.[6]

FEMA operates the NFIP, providing flood insurance through the Standard Flood Insurance Policy. Currently, homeowner policies are governed by the Dwelling Form, which also covers "renters, landlords, mobile homeowners, and condo unit owners."[7] The Proposed Rule revises the Standard Flood Insurance Policy of the NFIP by creating a new "Homeowner Flood Form," which applies specifically to owners of residential buildings housing one-to-four families.[8] The Homeowner Flood Form would replace the Dwelling Form for those units. The proposed form is more streamlined than the current one. For example, rather than listing how different coverages apply to different categories of homes, all homes would have the same policy terms with differences expressed through the premium or purchased endorsements.[9]

The new Homeowner Flood Form would also provide homeowners with new flexibility to tailor the insurance products they purchase. For the first time, homeowners would have the opportunity to purchase additional coverage for basement flooding, temporary relocation costs, and builder's coverage.[10] Also under the Proposed Rule, homeowners would, by default, receive replacement cash value (the cost to return the home to its pre-flood quality) after a loss, rather than the actual cash value (the cost to replace the home at the time of loss minus the value of physical depreciation from the flood).[11] Currently, homeowners receive actual cash value by default in their policies. FEMA contends that households will recover more completely and effectively under the replacement cost value policy.[12] The Proposed Rule is flexible, however, and would allow homeowners to choose to opt-in to actual cost value coverage in exchange for a lower

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[4] 42 U.S.C. 4001 et seq.
[5] Proposed Rule, 89 Fed. Reg. at 8285–86;
[6] *Id.*; 42 U.S.C. § 4012a.
[7] Proposed Rule, 89 Fed. Reg. at 8283.
[8] *Id.* at 8283 & n.11.
[9] For example, the Dwelling Form lists out different types of coverage for homes build prior to a community's initial adoption of a Flood Insurance Rate Map, and those built after, while the Homeowner Flood Form would reflect those differences in the premium. *Id.* at 8283–84.
[10] *Id.* at 8287.
[11] *Id.* at 8283.
[12] *Id.*

premium.[13] Also to ease recovery, after a flood FEMA would allow homeowners to receive an advance payment of up to 5% of their policy limit immediately, prior to going through a claims process.[14]

As a general matter, FEMA contends that providing households the ability to tailor their insurance products will make households more aware of the risks associated with their choices, resulting in risk-mitigating behavior.[15] Other changes to the policy are more directly geared at improving resilience and reducing losses. These changes include covering the cost of more expensive flood-resistant materials when homeowners are rebuilding, with an eye towards decreasing flood damages in the next flood, as well as increasing coverage for loss prevention actions homeowners might take prior to a flood (e.g. building a sand bag levee).[16]

I. FEMA Should Take Additional Steps to Prevent Flood Losses, Through Advance Payments for Net-Beneficial Loss Prevention Measures and Disclosures on How Risk Mitigation Affects Premiums.

Flood insurance policies can promote behavioral changes that reduce overall flood losses.[17] Those avoided losses are a benefit that increase total social welfare.[18] In finalizing this rule, FEMA should make additional changes to the Homeowner Flood Form, which will help further reduce flood losses, including: (1) providing advance payments for loss prevention measures taken ahead of a flood; (2) disclosing on the declarations page how risk mitigation actions taken by a homeowner or community affect a household's premium and how climate change may increase the risk of flooding.

A. FEMA should provide advance payments for loss prevention measures taken by homeowners in preparation for an imminent flood.

An ounce of prevention is worth a pound of cure, and low-cost preventative measures can pay large dividends in avoided flood damages. The NFIP has historically covered "loss prevention" activities by homeowners—that is, activities like setting up a sand bag levee or installing a sump pump in preparation for an upcoming flood—up to $1,000.[19] The deductible does not apply to

[13] *Id.* at 8304.
[14] *Id.* at 8303–04.
[15] *Id.* at 8313.
[16] *Id.* at 8284 (discussing use of flood resistant materials); *id* at 8298 (discussing changes to coverage of loss prevention measures).
[17] It is common in the insurance industry to encourage certain behaviors to reduce anticipated losses. *Id.* at 8305 & n.75. For example, many health insurers offer rebates on gym memberships, as long as the client attends a certain number of times, in order to improve fitness. *See, e.g.*, Tatiana Homonoff et al., *Rebates as Incentives: The Effects of a Gym Membership Reimbursement Program*, J. HEALTH ECON., Mar. 2020, at 2, https://www.sciencedirect.com/science/article/pii/S0167629619310367#bib0120 (describing existing health insurer programs and evaluating the efficacy of one such program). When an insurer pays an insured for damages (or when an insured pays a premium to the insurer), the payment, in itself, is a transfer. *See, e.g.*, CIRCULAR A-4, *supra* note 3, at 57–58, 60. But when the payment results in beneficial behavioral changes, those benefits are attributable to the transfer. *Id.*
[18] FEMA acknowledges this in its Regulatory Impact Analysis. *See* FEMA, NATIONAL FLOOD INSURANCE PROGRAM: STANDARD FLOOD INSURANCE POLICY, HOMEOWNER FLOOD FORM, NOTICE OF PROPOSED RULEMAKING, REGULATORY IMPACT ANALYSIS 96–100 (Jan. 2024) (Docket No. FEMA-2024-0004) [hereinafter RIA].
[19] *See* 44 C.F.R. 62 Appendix A(1) at III.C.2.

loss prevention activities, meaning a homeowner does not have to pay anything out-of-pocket before coverage takes effect.[20] The Proposed Rule builds on this longstanding practice by removing the $1,000 cap on loss prevention activities—to be replaced with a policy-specific limit, listed on the declarations page—and removing prescriptive language about what types of preventative measures are covered.[21] The fact that the deductible does not apply to loss prevention activities allows FEMA to send a clear economic signal to homeowners.[22]

But an economic signal to spend money on loss prevention activities (that will be reimbursed) is not useful if a homeowner does not have money to spare. **FEMA should further encourage households to take protective measures by providing advance payments to homeowners for loss prevention activities, which could make it easier for households with little liquidity to protect their homes**. FEMA is already proposing to provide advance payments for damages incurred by a flood; it should do the same for pre-flood costs incurred to avoid those losses.

Homeowners can reduce flood damages through low-cost measures, such as deploying sand bags, installing a sump pump, or clearing out gutters.[23] These efforts may cost little but reduce damages substantially. According to FEMA, one inch of water can cause $25,000 in damage to a home, and floods of over 18 inches can cause significant damage to a home's electrical system.[24] A homeowner may spend less than a thousand dollars to build a levee out of sand bags, encircling their home.[25] Such a levee can prevent an 18-inch flood from entering a home, and much more costly damages.[26]

The National Flood Insurance Act explicitly grants FEMA the latitude to provide advance payments.[27] FEMA is using this authority in the Proposed Rule to allow homeowners, after a flood event, to recover up to 5% of their policy limit as an upfront payment prior to filing any claims.[28] FEMA reasons that providing a partial advanced payment will allow homeowners to

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[20] *See id.*

[21] Proposed Rule at 8298, 8304. Please note that FEMA appears to use the terms "loss avoidance" and "loss prevention" interchangeably, *compare id.* at 8304, 8306, 8323, 8325 *with id.* at 8321. We use the term "loss prevention" to be consistent with the language of the proposed Homeowner Flood Form.

[22] This is especially true as, in some cases, loss prevention activities may cost less than a homeowner's deductible—if a deductible applied, any economic incentive from coverage would be limited. *Sandbag Levee Saves Sorrento Homeowner from Flooding – and Grief*, FEMA (Feb. 11, 2011), https://www.fema.gov/case-study/sandbag-levee-saves-sorrento-homeowner-flooding-and-grief (noting that the cost of the sandbag levee was less than the homeowner's deductible).

[23] For an explanation of various loss prevention measures, please refer to NAT'L FLOOD INS. PROGRAM, FEMA, UNDERSTANDING FLOOD LOSS AVOIDANCE (2024), https://agents.floodsmart.gov/sites/default/files/fema_nfip-understanding-flood-loss-avoidance-flyer-03-2024.pdf.

[24] *Fact Sheet: Why Should I Buy Flood Insurance?*, FEMA (last visited Mar. 26, 2024), https://www.fema.gov/press-release/20210318/fact-sheet-why-should-i-buy-flood-insurance-0#:~:text=The%20Federal%20Emergency%20Management%20Agency,replacing%20doors%2C%20appliances%20and%20cabinetry.

[25] *Sandbag Levee Saves Sorrento Homeowner from Flooding – and Grief*, FEMA (Feb. 11, 2011), https://www.fema.gov/case-study/sandbag-levee-saves-sorrento-homeowner-flooding-and-grief.

[26] *Id.*

[27] "Any payments under this chapter may be made (after necessary adjustment on account of previously made underpayments or overpayments) in advance or by way of reimbursement, and in such installments and on such conditions, as the Administrator may determine." 42 U.S.C. § 4123.

[28] Proposed Rule, 89 Fed. Reg. 8284.

begin rebuilding immediately, by easing the pathway for a homeowner to secure a contractor to begin necessary work.[29] By the same dint, a homeowner with limited liquidity may not have the flexibility to buy materials necessary for loss prevention activities, knowing they will have to wait through a long claims process to be reimbursed. By providing an upfront payment, perhaps based on the median cost for such interventions, FEMA would make it easier for such homeowners to take low-cost, high-benefit actions to protect their homes. As with the advance payments currently in the proposal (which pertain to recovery for losses sustained in a flood),[30] FEMA could similarly require a claims process for pre-flood expenditures and could impose a cap on advance payments for preventative measures—if necessary to prevent fraud—or specify allowed uses, which FEMA has determined are net-beneficial.

B. *On the declarations page or in an accompanying rider, FEMA should disclose how flood resilience practices at the community and individual level affect a homeowner's premium and how climate change may increase the risk of flooding.*

FEMA awards reduced premiums to homes and communities that take measures to increase their flood resilience. In theory, this price signal should encourage both individual and collective action to increase resilience. But such action will happen only if homeowners are aware that their premium is tied to these mitigation activities.[31] As FEMA is designing the new Homeowner Flood Form and associated declarations page, it should take this opportunity to improve messaging to homeowners about the role risk and resilience play in premium calculations.[32]

In setting premiums, FEMA considers whether a home is protected by certain flood-resilience measures. A homeowner may receive a discounted premium if, for example, the machinery in their home has been elevated to above the first floor, the home is elevated, the walls have proper flood openings to avoid damage to the foundation, or the home is watertight and certified floodproof.[33] **On the declarations page, FEMA should disclose to homeowners whether there are actions they can take to reduce flood risk and how much those actions would reduce their premium.**

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[29] *Id.* at 8301.

[30] Regarding the advance payments for post-flood measures, homeowners are still required to complete the claims process at a later date. *Id.* at 8323. If the advance payment exceeds the covered loss, the homeowner will be required to repay the difference. *Id*.

[31] *Cf.* CIRCULAR A-4, *supra* note 3, at 26–27 (explaining how access to information can reduce market failures).

[32] Proposed Rule, 89 Fed. Reg. at 8284 (explaining that "[t]he proposed new Homeowner Flood Form . . . push[es] certain provisions to the declarations page for clarity," and that "[t]he insurance industry recognizes that many policyholders will not read their insurance policy and has endeavored to put critical information onto the declarations page to increase policyholder understanding of what is and is not covered."). Providing information to homeowners about their risk is certainly within FEMA's authority. In fact, FEMA is required to "from time to time take such action as may be necessary in order to make information and data available to the public, and to any State or local agency or official, with regard to-- (1) the flood insurance program, its coverage and objectives, and (2) estimated and chargeable flood insurance premium rates, *including the basis for and differences between such rates* in accordance with the provisions of section 4015 of this title." 42 U.S.C. § 4020 (emphasis added).

[33] FEMA, NAT'L FLOOD INS. PROGRAM, FLOOD INSURANCE MANUAL: RISK RATING 2.0 EQUITY IN ACTION EDITION 3-27 to 3-29 (2022), https://www.fema.gov/sites/default/files/documents/fema_nfip-flood-insurance-manual-sections-1-6_102022.pdf [hereinafter FLOOD INSURANCE MANUAL].

FEMA should also provide additional disclosures about the availability of premium discounts for taking actions that decrease community risk. Under the Community Rating System (CRS), communities receive a rating based on their engagement in floodplain management activities, which corresponds to a class.[34] Depending on a community's CRS class, homeowners in that community receive discounts of up to 45% on their premiums.[35] Community-level flood mitigation projects can result in large savings from reduced flood losses and may be more efficient than actions taken at the individual household level.[36]

Even though it can be advantageous for communities to engage in greater flood mitigation efforts, it is not clear to what extent homeowners are aware that they would benefit from such actions through lower premiums. As of 2022, fewer than half of homeowners living in a high-risk flood area were even aware they lived in a floodplain.[37] These facts suggest that homeowners may not have enough information about flooding to make informed requests of their local governments. To address this, **FEMA should add a disclosure to the new form informing homeowners what percent reduction they receive on their premium as a result of community-level mitigation efforts and the maximum reduction the homeowner could receive if their community took additional steps to reduce risk.** This information could help grow political will for local mitigation efforts, which could ultimately result in greater avoided losses.[38]

For similar reasons, FEMA should also consider adding a disclosure to the form providing homeowners with information about their present risk, and noting that climate change will increase future flooding risk in many areas, including by causing flooding to exceed historical levels and by putting new areas at risk of flooding. As noted above, many homeowners are

[34] FEMA, NAT'L FLOOD INS. PROGRAM COMMUNITY RATING SYSTEM, COORDINATOR'S MANUAL 110-3 (2017), https://www.fema.gov/sites/default/files/documents/fema_community-rating-system_coordinators-manual_2017.pdf; FLOOD INSURANCE MANUAL, *supra* note 33, 3-7 to 3-8.

[35] FLOOD INSURANCE MANUAL, *supra* note 33, at 3-8.

[36] *Compare Loss Avoidance Study: Iowa Flood Reduction Projects*, FEMA (last visited Mar. 25, 2024) (summarizing nine minor flood reduction projects that avoided about $53 million in damages, less than a third into the projects' expected lifespan, at a cost of only $2.6 million) *with FEMA Fact Sheet: Hurricane Ida 2021: Jefferson Parish Louisiana*, FEMA (2022), https://www.fema.gov/sites/default/files/documents/fema_louisiana-loss-avoidance-study_report.pdf (showing avoided losses of $5.3 million for a $2.4 million cost to elevate homes). Some CRS activities also direct future development in a flood-safe way, as opposed to having an effect on flood risk for existing homes.

[37] Saif Amin & Li-Ning Huang, *Challenges Remain in Raising Consumer Awareness of Flood Risk*, FANNIE MAE PERSPECTIVES BLOG (Dec. 12, 2023), https://www.fanniemae.com/research-and-insights/perspectives/challenges-remain-raising-consumer-awareness-flood-risk (13% of respondents in high-risk flood zones did not think they lived near a flood zone at all, 28% thought they lived *near* a flood zone, 15% didn't know or were unsure, and the remainder thought they lived in either a 100-year or 500-year flood plain). Interestingly, according to FEMA, the average community in the CRS scores only 34 points out of a possible 120 for "[i]nvolv[ing] the public" in the mitigation planning process. FED. EMER. MGMT. AGENCY, MITIGATION PLANNING AND THE COMMUNITY RATING SYSTEM: KEY TOPICS BULLETIN 7 (2018), https://www.fema.gov/sites/default/files/2020-06/fema-mitigation-planning-and-the-community-rating-system-key-topics-bulletin_10-1-2018.pdf.

[38] Research suggests that CRS communities have lower flood losses, as compared to similar communities that do not participate in CRS. Wesley E. Highfield & Samuel D. Brody, *Determining the Effects of the FEMA Community Rating System Program on Flood Losses in the United States*, 21 INT'L J. DISASTER RISK REDUCTION 396, 402–03 (2017); *see also* Wesley E. Highfield & Samuel D. Brody, *Evaluating the Effectiveness of Local Mitigation Activities for Reducing Flood Losses*, 14 NAT'L HAZARDS REVIEW 229, 235 (2013) (finding the greatest reductions in flood damage among communities that engage in freeboard requirements, open space protection, and flood protection).

unaware of their flood risk[39]—and the Proposed Rule may not be able to spur wider adoption of harm-avoidance practices and insurance policy adoption if homeowners are inadequately informed of their risks. Climate change will generally exacerbate flood risk because, in many regions, climate change is increasing the magnitude and frequency of flooding as well as expanding the size of the floodplain.[40] FEMA's flood maps are often out-of-date and do not reflect how climate change will shape future flood risk.[41] FEMA should increase homeowner knowledge about how climate change is exacerbating flood risk, by informing them that these changes are not currently reflected in flood maps. This knowledge could help homeowners better respond to FEMA's nudges to increase insurance uptake and adoption of actions to prevent flooding, which would ultimately decrease flood risk.[42] **For example, FEMA could include, on the declarations page, text containing something like the following: "According to our maps, your home is located in [floodplain type], meaning [short description of floodplain]. However, your risk may be higher than that indicated by our maps because flooding has been increasing in many places due to more frequent and severe heavy precipitation events, riverine flooding, and storm surge." FEMA could also consider tailoring the language at the end of the sentence to reference the types of risks most relevant to policyholders in that area, e.g. the risk of storm surge and coastal flooding for policyholders located near the coast.**

FEMA could also consider using pilot projects to test the effectiveness of different formats for disclosures around individual mitigation options, community mitigation options, and present and future risks associated with climate change. Different formats, lengths, and levels of detail in such disclosures may present different costs and benefits; some options may prove more

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[39] Amin & Huang, *supra* note 37.

[40] *See, e.g.*, DENA ADLER & JOEL SCATA, SABIN CTR. CLIMATE CHANGE & NAT'L RES. DEF. COUNCIL, BREAKING THE CYCLE OF "FLOOD-REBUILD-REPEAT": LOCAL AND STATE OPTIONS TO IMPROVE SUBSTANTIAL DAMAGE AND IMPROVEMENT STANDARDS IN THE NATIONAL FLOOD INSURANCE PROGRAM 3–4 (2019), https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1071&context=sabin_climate_change; AECOM, THE IMPACT OF CLIMATE CHANGE AND POPULATION GROWTH ON THE NATIONAL FLOOD INSURANCE PROGRAM THROUGH 2100 (2013), https://www.aecom.com/content/wp-content/uploads/2016/06/Climate_Change_Report_AECOM_2013-06-11.pdf. For a more detailed discussion of the effects of climate change on flooding, please refer, *infra*, to the discussion accompanying notes 46 to 57.

[41] *See* Sarah Kuta, *Federal Flood Maps Are Outdated Because of Climate Change, FEMA Director Says*, SMITHSONIAN MAG. (Sept. 8, 2022), https://www.smithsonianmag.com/smart-news/federal-flood-maps-are-outdated-because-of-climate-change-fema-director-says-180980725/ ("FEMA's maps right now are really focused on riverine flooding and coastal flooding, . . . When we're seeing these record rainfalls that are happening . . . that's what our flood maps don't necessarily take into consideration."); *see also* OFF. OF INSPECTOR GENERAL, FEMA NEEDS TO IMPROVE MANAGEMENT OF ITS FLOOD MAPPING PROGRAMS 2 (2017), https://www.documentcloud.org/documents/4066233-OIG-17-110-Sep17.html (finding that "FEMA needs to improve its management and oversight of flood mapping projects to achieve or reassess its program goals and ensure the production of accurate and timely flood maps.").

[42] A similar recommendation was made by the Technical Mapping Advisory Council, which was created by Congress to advise FEMA on how to update flood maps. *See* JOHN DORMAN ET AL., TECHNICAL MAPPING ADVISORY COUNCIL, FUTURE CONDITIONS RISK ASSESSMENT AND MODELING at 6-1 to 6-2 (Dec. 2015), https://www.fema.gov/sites/default/files/documents/fema_tmac_2015_future_conditions_risk_assessment_modeling_report.pdf ("By providing residents in floodprone areas with information on the insurance premium that reflects their flood-related risk next year and how it is likely to change in future years, individuals may then recognize how hazardous the area is in which they are living or working. They may be more likely to adopt cost-effective mitigation measures for reducing the damage to their property from future floods.")

effective than others at educating consumers and translating to beneficial actions. Pilot programs, as recommended in Circular A-4, could help FEMA test the costs and benefits of different disclosure options.[43]

Although FEMA's premium-setting program sends a clear price signal, tied to risk, it is not evident that homeowners have the necessary information to respond to the price signal. Providing additional disclosures on the declarations page would make these price signals more salient, encouraging the uptake of adaptive behavior.[44]

II. FEMA Should Revise the RIA to Conform to Best Practices Under Circular A-4.

Consistent with best practices in the updated Circular A-4.[45] FEMA should strengthen its economic analysis by (1) using a baseline that reflects increased flooding due to climate change; and (2) analyzing the distributional impacts of the Proposed Rule.

A. FEMA should choose a baseline that reflects increased climate change-related flooding and assess how the changing baseline affects the costs and benefits of the Proposed Rule.

FEMA's baseline fails to account for how climate change will increase the frequency and magnitude of flooding. In so doing, FEMA's analysis underestimates future flood damages and, as a result, underestimates the flood damage-reduction benefits of the Proposed Rule.

Circular A-4 defines a baseline as "an analytically reasonable forecast of the way the world would look absent the regulatory action being assessed."[46] It specifies that this baseline should reflect "conditions [that] will change absent the regulation," and that "[i]f a harm addressed by a regulation is expected to become more severe over time, the baseline should reflect that trend."[47] Considerations that can change a baseline include "alterations to the climate," if those changes will have a significant impact on the regulation's effects.[48] In the Proposed Rule, FEMA recognizes that flood risk is increasing as a result of climate change, but the RIA does not reflect these baseline changes.[49] Instead, FEMA uses flood insurance claims from 2010–2019 to

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[43] CIRCULAR A-4, *supra* note 3, at 24 ("If it is difficult to determine which regulatory alternative is the optimal choice, and if timing and other circumstances allow, consider analyzing the alternative of developing one or more pilot projects to test the measures under consideration").

[44] *Id.* at 26 ("To be effective, measures to improve information availability should be clear, meaningful, timely, salient, and designed to be sensitive to how people process and make choices based on that information.").

[45] *Id.* at 11, 62–63 (2023). This is a longstanding analytical approach to baseline setting. It is consistent with the 2003 version of Circular A-4, which explains that setting a baseline may require consideration of "changes in external factors affecting expected benefits and costs" and that an analysis "should provide a separate description of distributional effects . . . so that decision makers can properly consider them along with the effects on economic efficiency." OFF. OF MGMT. & BUDGET, CIRCULAR A-4: REGULATORY ANALYSIS 14–15 (2003).

[46] CIRCULAR A-4, *supra* note 3, at 11.

[47] *Id.*

[48] *Id.*

[49] Proposed Rule, 89 Fed. Reg. at 8282; RIA, *supra* note 18 at 11, 26.

estimate flood insurance claims for the coming decade.[50] It notes only that the incidence of future flood insurance claims could "vary drastically" from past incidence, but does not suggest in what direction the estimate is likely to change.[51] Rather than merely noting that claim incidence could vary, FEMA should explain that future flood insurance claims will likely *increase* due to climate change.

It is well-established that climate change will increase the magnitude and frequency of flooding in many places throughout the United States.[52] Climate change will exacerbate flood risk through a combination of factors, including more frequent and heavier precipitation events, sea level rise, and greater storm surge.[53] These factors also serve to expand the floodplain, which in conjunction with population growth, will leader to more homes located in Special Flood Hazard Areas (SFHAs), more insurance policies, and more repetitive loss properties.[54] The Fifth National Climate Assessment estimates that U.S. annual average losses from floods will increase by 26.4% between 2020 and 2050, with heavier losses in communities of color.[55] On the very first line of the Executive Summary of the Proposed Rule, FEMA recognizes that climate change is causing increased flooding and flood risk.[56] And on the front page of its website, FEMA attributes the 660% increase in NFIP claims between 1980-2000 and 2000-2020 to climate change.[57]

A baseline that incorporates climate change would presumptively increase projected regulatory benefits and net benefits, because many of the identified benefits are avoided flood losses, which will scale up with increased flooding. FEMA identifies the primary benefits of the Proposed Rule to include "more accurate signaling of risk to homeowner policyholders . . . (thus incentivizing them to reduce their risks), environmental benefits of loss mitigation, reducing the need for

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[50] RIA, *supra* note 18, at 11, 26.
[51] *Id.* at 11.
[52] Alexa K. Jay et al., *Chapter 1: Overview: Understanding Risks, Impacts, and Responses at 20*, *in* FIFTH NATIONAL CLIMATE ASSESSMENT (2023), https://nca2023.globalchange.gov/downloads/NCA5_Ch1_Overview.pdf; *see also* Elizabeth A. Payton et al., *Chapter 4: Water, in* FIFTH NATIONAL CLIMATE ASSESSMENT 4-12, 4-17 (2023), https://nca2023.globalchange.gov/downloads/NCA5_Ch4_Water.pdf; Christine L. May et al., *Chapter 9: Coasts, in* FIFTH NATIONAL CLIMATE ASSESSMENT 9-8 to 9-9 (2023), https://nca2023.globalchange.gov/downloads/NCA5_Ch9_Coasts.pdf.
[53] *See* Jay et al., *supra* note 52, at 20; *see also* Sonia I. Seneviratne et al., *Chapter 11: Weather and Climate Extreme Events in a Changing Climate*, *in* CLIMATE CHANGE 2021: THE PHYSICAL SCIENCE BASIS. CONTRIBUTION OF WORKING GROUP I TO THE SIXTH ASSESSMENT OF THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE 1518 (2021), https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_Chapter11.pdf.
[54] *See, e.g.*, DENA ADLER & JOEL SCATA, SABIN CTR. CLIMATE CHANGE & NAT'L RES. DEF. COUNCIL, BREAKING THE CYCLE OF "FLOOD-REBUILD-REPEAT": LOCAL AND STATE OPTIONS TO IMPROVE SUBSTANTIAL DAMAGE AND IMPROVEMENT STANDARDS IN THE NATIONAL FLOOD INSURANCE PROGRAM 3–4 (2019); https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1071&context=sabin_climate_change; AECOM, THE IMPACT OF CLIMATE CHANGE AND POPULATION GROWTH ON THE NATIONAL FLOOD INSURANCE PROGRAM THROUGH 2100 ES-7 (2013), https://www.aecom.com/content/wp-content/uploads/2016/06/Climate_Change_Report_AECOM_2013-06-11.pdf.
[55] Jay et al., *supra* note 52, at 20.
[56] Proposed Rule, 89 Fed. Reg. at 8282.
[57] FEMA & NFIP, *Climate Change Increases Risk of Flooding*, FLOODSMART (last visited May 30, 2024), https://www.floodsmart.gov/climate-change ("From 1980–2000, the NFIP paid almost $9.4 billion in flood insurance claims. From 2000–2020, that number increased over 660% to $62.2 billion due to the changing climate.").

Federal assistance, and collaborating with industry stakeholders to create a policy that meets the needs of those involved."[58] In other words, the benefits of the Proposed Rule include anticipated behavioral changes, in light of changes in insurance coverage and messaging, that ultimately result in flood risk reduction. For example, the Proposed Rule would amend coverage to cover the cost of rebuilding a home with flood-resistant materials, which would result in reduced losses from future floods.[59] Many of the benefits identified by FEMA stem from reduced flood damages[60]—and so these benefits generally increase under a baseline of more frequent and severe floods.

The primary costs FEMA identifies with the Proposed Rule are training and implementation costs, as states and insurance representatives will need to familiarize themselves with the new Homeowner Flood Form. These costs seem unlikely to be significantly affected by the interaction between the Proposed Rule and climate change, although there could be an increase in administrative costs for processing claims under a revised baseline. To the extent climate change results in the administration of substantially more flood insurance policies, necessitating training of additional insurance agents, only the component of additional training caused by the revisions to the form could be attributed to the Proposed Rule.

While it may be challenging for FEMA to quantify how flooding will increase, it should nonetheless acknowledge that climate change is increasing flood risk in many regions and discuss, at least qualitatively, how that increased flood risk will affect the costs and benefits of the Proposed Rule. In so doing, FEMA may find it useful to analyze regional data from the National Climate Assessment, including projections of future flood losses in different parts of the country,[61] and compare anticipated changes in future flooding with its internal data on insurance coverage in different regions. FEMA could navigate uncertainty regarding the magnitude of future flood risk, and the corresponding uncertainty about damages experienced by policyholders, by expressing its expectations as a range. Alternately, FEMA could conduct a purely qualitative analysis.

B. FEMA should conduct a distributional analysis of the Proposed Rule to improve its understanding of the costs and benefits of its action on different communities.

Policies can have different impacts on different communities, so it is important to understand how the costs and benefits of a policy change will be distributed. Conducting a distributional analysis, as consistent with best practices under Circular A-4, can help FEMA better understand the effects of its Proposed Rule on different communities and support informed decisionmaking

[58] RIA, *supra* note 18, at 12.
[59] Proposed Rule, 89 Fed. Reg. at 8284, 8305.
[60] *See, e.g.*, RIA, *supra* note 18, at 96–97 (explaining increased clarity in coverage reduces loss because "if a homeowner policyholder understands that personal property items receive less or no coverage in areas of the dwelling with higher flood risk, such as basements or enclosures, this could incentivize a homeowner policyholder to keep uninsured or high-value items in less risky areas of the dwelling. This prevents unnecessary loss, which potentially reduces both uncovered damage as well as claims."); *id.* at 99 ("By implementing loss-mitigation measures, FEMA expects less severe damage to those properties in the future, leading to quicker and more complete recovery for policyholders and their households, incentivizing them to improve resilience.").
[61] Chapters 21 to 30, *in* FIFTH NATIONAL CLIMATE ASSESSMENT (2023), https://nca2023.globalchange.gov/regions/.

and policy design. As this section explains further, even in a situation such as the Proposed Rule, where many of the effects are considered transfers, there can still be significant distributional effects.

Much of the Proposed Rule concerns changes that will transfer resources from one party to another. For example, when FEMA provides additional coverage (like basement coverage), both premiums (paid from homeowners to the NFIP) and insurance payouts (paid from the NFIP to homeowners) increase. These payments are transfers between the homeowners and the government.[62] At the same time, the Proposed Rule adopts opt-out strategies to nudge homeowners into certain coverage options, such as being insured for the replacement—rather than actual—cost value of their home.[63] Other elements of the Proposed Rule incentivize behavioral changes that result in certain net benefits for society, such as reduced flood damages through greater use of preventative measures.[64] **Although transfers are composed of offsetting costs and benefits, the effect of those transfers, including distributional effects or behavioral changes, may increase or decrease net social benefits**.[65]

FEMA has not conducted a distributional analysis of the Proposed Rule to assess how changes in transfers (such as increased premiums) or changes in benefits (such as decreased flood risk) will affect different communities. **FEMA should conduct a qualitative distributional analysis to ensure that the Proposed Rule does not create regressive cross-subsidization of low-income households to high-income households, to understand how increased insurance premiums from homes being opted-in to higher coverage will affect lower-income households, and to assess how providing advance payments and replacement cost value will benefit low-income households.**

By failing to conduct a distributional analysis, FEMA may be undervaluing the benefits of the Proposed Rule by ignoring potentially desirable distributional benefits. For example, FEMA explains in the Proposed Rule that allowing homeowners to choose between replacement and actual cost value could provide needed flexibility to low-income customers, and replacement cost value may help homeowners with depreciated home values recover more quickly.[66] Similarly, the Proposed Rule would provide advance payments to homeowners following a flood, allowing them to begin rebuilding immediately; this is likely most meaningful to homeowners who have limited liquidity, including low-income homeowners.[67] By considering

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[62] *See* CIRCULAR A-4, *supra* note 3, at 57–59.
[63] *See* Proposed Rule, 89 Fed. Reg at 8283.
[64] *See, e.g.*, *infra* note 60.
[65] In the RIA, FEMA states that "Transfers such as . . . insurance payments, . . . can have significant efficiency effects *in addition to distributional effects* and are not included in the estimates of the benefits and costs of a regulation." *See* RIA, *supra* note 18, at 88 (emphasis added). It is unclear from this language whether FEMA considered the distributional effects of transfers in its analysis. Desirable and undesirable distributional effects from transfers are relevant to FEMA's regulatory decisionmaking. FEMA should consider the distributional effects that result from transfers as part of its analysis if feasible. *See* CIRCULAR A-4, *supra* note 3, at 60.
[66] Proposed Rule, 89 Fed. Reg. at 8290.
[67] *Id.* at 8303–04.

this benefit in the context of low-income homeowners, FEMA can better understand whether other modifications, such as a higher advance payment, would be desirable.

At the same time, it is possible that other elements of the program may create undesirable distributional consequences. Under the status quo, for example, both primary and secondary homes are reimbursed actual cash value, but under the Proposed Rule, both would receive replacement cost value as the default option.[68] While receiving replacement value rather than cash value may yield important benefits for low-income policyholders whose homes are flood damaged, it is possible there could be some less desirable distributional effects. For example, although increased risks are partially priced into premiums and premiums are related to housing price, FEMA should nonetheless ensure that money from premiums paid by low-income homeowners (and—when the NFIP has a shortfall in funding—taxpayers, more generally[69]) are not being used to cross-subsidize flood insurance for secondary homes. In the future, FEMA may want to consider whether primary and secondary homes should be treated differently, particularly given the moral hazard associated with subsidizing the risk of secondary homes in floodplains, the environmental costs of floodplain development, and the fact that taxpayers writ large increasingly subsidize the NFIP.[70] It is not clear whether or not cross-subsidization is happening, but to put these concerns to rest, FEMA should conduct an analysis and draw a conclusion. FEMA should consider conducting such analysis in a final RIA.

There is also a risk that the Proposed Rule could reduce coverage in low-income areas. Because the default coverage would be the more expensive replacement cost value, rather than actual cost value, low-income households might be dissuaded from purchasing insurance. FEMA examines how premiums will increase under the Proposed Rule only in the aggregate.[71] It should also examine how the average premium of a home in a lower-income community would change, and use its findings to inform how FEMA designs training materials for insurance agents. In short, even if the switch to a default option of reimbursing replacement cost value improves post-flood recovery (an important regulatory benefit), it could have undesirable distributional effects (and

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[68] *Id.* at 8305.

[69] In October 2017, Congress forgave $16 billion of NFIP's debt; today, the NFIP owes the federal government roughly $20 billion. DIANE P. HORN, CONG. RSCH. SERV., NATIONAL FLOOD INSURANCE PROGRAM BORROWING AUTHORITY 3 (Apr. 1, 2024), https://crsreports.congress.gov/product/pdf/IN/IN10784.

[70] In theory, a homeowner's premium should reflect the risk of the insurance product, in which case there would be no moral hazard. In practice, NFIP premiums have historically been insufficient to cover NFIP's costs, and therefore do not fully reflect the risk. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFF., FLOOD INSURANCE: FEMA'S NEW RATE-SETTING METHODOLOGY IMPROVES ACTUARIAL SOUNDNESS BUT HIGHLIGHTS NEED FOR BROADER PROGRAM REFORM 1–2 (July 2023), https://www.gao.gov/assets/gao-23-105977.pdf. In some cases, redlining pushed low-income communities and communities of color into locations with higher flood risk; this is not reasonable to frame as a moral hazard. *See, e.g.*, Jacob Napieralsky et al., *Buried But Not Dead: The Impact of Stream and Wetland Loss on Flood Risk in Redlined Neighborhoods*, CITY & ENVT. INTERACTIONS, Jan. 2024, at 5–6. In contrast, when high-income households choose to build vacation homes or new development in flood-risky areas—in some cases causing ecological damage that further increases community-wide risks—and that risk is not fully reflected in the insurance premium, there is a moral hazard. *See* SADIE FRANK ET AL., BROOKINGS, INVITING DANGER: HOW FEDERAL DISASTER INSURANCE AND INFRASTRUCTURE POLICIES ARE MAGNIFYING THE HARM OF CLIMATE CHANGE 7 (2021), https://www.brookings.edu/wp-content/uploads/2021/03/Inviting_Danger_FINAL.pdf ("These federal backstops can create what economists call moral hazard because they incentivize people take on risks they otherwise would not because they do not bear the full cost of those risks. It is a kind of subsidy.").

[71] *See, e.g.*, RIA, *supra* note 18, at 80–81.

reduced overall benefits) if the higher apparent cost discourages low-income households from enrolling.

The White House has encouraged the use of distributional analysis for over 30 years. Executive Order 12,866, issued by President Clinton in 1993, instructs agencies to incorporate equity considerations into their cost-benefit analyses and regulatory decisions.[72] It specifically recognizes that "distributive impacts" and "equity" are relevant to assessing net benefits.[73] In 2011, President Obama issued Executive Order 13,563, which reaffirmed Executive Order 12,866 and stated that agencies conducting cost-benefit analysis "may consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts." The updated Circular A-4 explains that "who will ultimately experience the benefits and bear the costs of any regulation warrants close attention in a distributional analysis."[74]

Even if FEMA anticipates minimal distributional impacts, conducting an analysis can better inform reasoned decisionmaking, consistent with Executive Orders and best practices under Circular A-4. This analysis can be a qualitative discussion of how policy choices made in the Proposed Rule burden different populations (e.g., through increased premium costs) or benefit them (e.g., advance payments post-flood), how those costs and benefits could affect behavior, and whether it is likely that increased premiums paid by low-income households will result in subsidization to higher income households. To the extent FEMA's analysis reveals undesirable distributional consequences, in a separate action, FEMA may also want to consider how it could further reduce flood risk (and premiums) in low-income communities through targeted educational outreach, advising flood-safe practices, and grantmaking at the individual or community level.

III. FEMA Should Add Cross-References Within the Body of the Policy, Where the General Policy Conflicts with Endorsements That Homeowners May Have Purchased.

The Proposed Rule creates five new endorsements that will allow homeowners to tailor the coverage they receive.[75] Based on FEMA's presentation in the Proposed Rule, the Homeowner Flood Form will include language applicable to all policies, with the language of the various endorsements in appendices at the end. In some cases, however, the language of the general agreement, applicable to all homeowners, conflicts with the language in the endorsements. Although it is a general principle of insurance contract interpretation that a rider or endorsement should be read alongside a policy and that, in the case of a conflict, the endorsement controls,[76] an average homeowner is unlikely to be well-versed in contract law. To that end, in order to

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[72] Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993).
[73] *Id.* at § 1, 51,735.
[74] CIRCULAR A-4, *supra* note 3, at 60–67.
[75] Proposed Rule, 89 Fed. Reg. at 8283–84.
[76] *See, e.g.*, ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS § 6:2 (6th ed. 2024) ("Endorsements should, if possible, be construed together with the terms of the insurance policy to which they are attached, although as discussed below, if they are inconsistent, the endorsement controls.").

make things clearer for homeowners, and to remind homeowners of the availability of these endorsements, FEMA should reference the endorsement coverages within the body of the main policy document, where the policy and endorsements currently conflict. This change would make the policy easier for homeowners to understand, potentially saving policyholders time and stress.[77] The change may also put homeowners who did not purchase additional coverage on notice that the coverage exists, which could lead to increased uptake and a greater understanding of risk. We suggest the following language:

- **Increased Cost of Compliance:** At the end of Section IV.A.2, add "If your Declarations page indicates that you purchased additional coverage under the Increased Cost of Compliance Endorsement, you may be able to recover for costs related to compliance. Refer to Appendix A(101) for an explanation of that endorsement."
- **Actual Cash Value:** At the end of Section VI.E.1.b.2. add "If your Declarations page indicates that you selected Actual Cash Value coverage, refer to Appendix A(102)."
- **Temporary Housing Expenses:** Add, at the end of Section III.A.4.a., "unless your Declarations page indicates that you purchased additional coverage under the Temporary Housing Expense Endorsement, in which case, refer to Appendix A(103)."
- **Basement Coverage Endorsement:** In Section III.A.2**,** before "[w]e only cover . . ." add, "Unless your Declarations page indicates that you purchased additional coverage under the Basement Coverage Endorsement, in which case, refer to Appendix A(104),"

Conclusion

When FEMA finalizes the Proposed Rule, it should: (1) take additional steps to reduce flood losses, including by providing advance payments for loss prevention measures and additional disclosures about homeowner and community risk; (2) update the RIA by choosing a baseline more reflective of climate change and conducting a distributional analysis; and (3) clarify elements of the policy that contradict the endorsements to make the policy easier for the average homeowner to understand.

Respectfully,

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[77] *See* RIA, *supra* note 18, at 96–97 (discussing benefits of improving the clarity of the form).