



Flood Insurance

The Final Flood Insurance Q&As Are Here!

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THEY ARE FINALLY HERE! The industry has been (im)patiently waiting for the finalization of flood insurance questions and answers (Q&As) from the five federal regulatory agencies (Agencies): the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve, Farm Credit Administration, and the National Credit Union Administration. The Q&As were jointly issued on May 11, 2022 and published in the Federal Register on May 31, 2022 ("Interagency Questions and Answers"). Based on banker feedback and the most frequently asked questions from lenders on a wide spectrum of technical flood insurance-related compliance issues, the final Q&As replace those originally published by the agencies in 1997 and updated in 2009 and 2011. These rules have been a long time coming.

In October 2013, the Agencies jointly issued proposed rules to implement the escrow, force placement, and private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 (BWA). In March 2014, Congress enacted the Homeowner Flood Insurance Affordability Act (HFIAA), which, among other things, amended the BWA's requirements regarding the escrow of flood insurance premiums and fees, and created a new exemption from the mandatory flood insurance purchase requirement for certain detached structures.

BWA was not finalized until February 2019 and in the intervening years, there was industry-wide confusion and lack of compliance guidance around the acceptance of private flood insurance. To implement the significant changes from BWA and HFIAA, the Agencies proposed new and revised Q&As in July 2020 that covered the changes, with updates made in 2021.

In 2021, the Federal Emergency Management Agency (FEMA) began updating the National Flood

Insurance Program (NFIP) risk rating methodology through the implementation of Risk Rating 2.0—Equity in Action. The methodology leverages industry best practices and cutting-edge technology to enable FEMA to better reflect a property's flood risk and set rates that are fairer and ensures rate increases and decreases are both equitable. The Agencies revised some Q&As because of changes made in Risk Rating 2.0

The final Q&As reflect these significant changes to the flood insurance requirements and provide clarity around force placement and subordinate liens. The Q&As were reorganized by topic to provide a more logical flow through the flood insurance process, and the guidance provides a helpful table of contents listing the new categories of questions and a redesignation table that outlines where specific questions from the previous version are updated.

Background

Per FEMA statistics, flooding is the costliest natural disaster in the United States. In the face of mounting flood losses and escalating costs of disaster relief, Congress enacted the National Flood Insurance Act of 1968 (the Act) creating the NFIP, a program that makes federally backed flood insurance available in those states and communities that agree to adopt and enforce flood-plain management ordinances to reduce future flood damage. The Act gives property owners in participating communities access to flood insurance protection made available by the federal government for buildings and their contents.

The Flood Disaster Protection Act (FDPA) of 1973 established the mandatory flood insurance purchase requirement and created responsibility for enforcing the requirement by federally regulated lenders that make a designated loan in certain high flood risk areas.

The FDPA prohibits federally regulated lenders from making, increasing, renewing, or extending loans secured by buildings or mobile homes located or to be located in a Special Flood Hazard Area of a community participating in the NFIP, unless the real and personal property securing the loan is covered by flood insurance. Lenders are subject to regulatory violations and fines if they fail to enforce the mandatory purchase requirement.

The Agencies believe the revised guidance will assist lenders in meeting their responsibilities under the law and increase the public's understanding of the Agencies' respective flood insurance regulations.

Highlights of New or Revised Q&As

There are over 140 Q&As covered in detail in the guidance. Key highlights are discussed here.

One of the most welcome statements from the Agencies confirms that the Q&As are guidance. Specifically, the Q&As state:

"The Agencies confirm that the Agencies are providing the Interagency Questions and Answers as guidance only."

It is important that lenders and regulators understand the proper role of guidance, which is to inform bank policy and procedure but does not carry the force or weight of statute or regulations; in other words, guidance is not enforceable. Lenders should raise this distinction with examiners when appropriate.

A few Q&As mention a lender's ability to protect its property based on safety and soundness purposes as a condition of a loan being made regardless of regulatory requirements, and specifically note that each lender should tailor its own flood insurance policies and procedures to suit its business needs and protect its ongoing interest in the collateral. Of course, lenders must always comply with regulatory requirements first.

No Reconciliation of Discrepancies Expected

Zone 1: The Agencies redesignated existing Q&A 71 as Q&A Zone 1, which updates and revises prior guidance regarding a lender's obligation in the event a flood zone discrepancy exists between the Standard Flood Hazard Determination Form and the flood insurance policy. Q&A Zone 1 states a lender is no longer required to attempt to resolve the discrepancy.

Risk Rating 2.0: As mentioned, FEMA began to implement Risk Rating 2.0 effective October 1, 2021. Under Risk Rating 2.0, the determination of insurance premiums for NFIP policies no longer relies on the flood zone, and as such, the flood zone will no longer be included on the declarations page for NFIP policies issued under Risk Rating 2.0 (note that prior flood insurance policies may still

reflect the flood zone). Consistent with these changes, the Agencies removed references to the declarations page and stated that a lender need not reconcile or otherwise be concerned with a flood zone discrepancy to comply with the Act and the Regulation.

Section XIV. Requirement to Escrow Flood Insurance Premiums and Fees – General (Escrow):

Section XIV clears up several issues related to escrow requirements:

Escrow 3: States lenders must escrow force-placed flood insurance premiums because there is no exception for force-placed insurance.

Escrow 6: Clarifies that a junior lienholder is not required to escrow for flood insurance if the borrower has obtained sufficient flood insurance coverage. If the primary lienholder has not obtained adequate flood insurance, the junior lienholder would need to ensure adequate flood insurance is in place and would need to escrow for that flood insurance premium. The answer also states that the escrow requirements would not apply to a junior lien that is a home equity line of credit (HELOC), since HELOCs have a separate escrow exception under the Act and Regulation.

Detached structure

The Agencies redesignated existing Q&A 18 as Q&A Exemptions 1, which discusses the exemptions from the mandatory flood insurance purchase requirement. The Q&A was revised to include the detached structure exemption in addition to the existing exemptions for State-owned property and loans with an original principal balance of \$5,000 or less and an original repayment term of one year or less.

The Q&A notes that although an exemption may apply, a borrower may still elect to purchase flood

insurance or a lender may still require flood insurance on a detached structure as a condition of making the loan for purposes of safety and soundness, depending on its risk analysis.

Acceptance of Private Flood Insurance

Q&As related to private flood insurance are included in Sections III, IV and V, highlighting the amount of uncertainty that existed in the industry on this topic. The final guidance provides clarity around the Compliance Aid and mandatory acceptance of these policies.

Section III Mandatory Acceptance: A lender may determine that a policy meets the definition of private flood insurance, without further review of the policy, if the following statement is included within the policy or as an endorsement to the policy: "This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation."

Mandatory 4: This confirms that a lender cannot reject a policy simply because it does not include a compliance aid statement. If a policy does not meet the mandatory acceptance criteria, the lender may still accept the policy if it meets the discretionary acceptance criteria, or, if applicable, the mutual aid plan criteria (see also Q&A Mandatory 7). If a policy does not meet the compliance aid, discretionary acceptance, or mutual aid provisions, a lender may not accept it.

Mandatory 5: If a lender relies on the compliance aid statement, further review of the policy is not necessary to determine if the policy meets the definition of "private flood insurance", and a lender can still accept a compliance aid statement if there are only stylistic differences.

Mandatory acceptance: A policy must provide coverage at least as broad as the coverage provided under a Standard Flood Insurance Policy (SFIP) for the same type of property, including a

deductible that is no higher than the specified max under an SFIP for any total coverage amount up to the max available under the NFIP at the time the policy is provided to the lender.

Discretionary 4: Identifies factors a lender may consider when determining whether a flood insurance policy issued by a private insurer or mutual aid plan provides sufficient protection of the loan, consistent with safety and soundness principles. These factors include whether:

1. A policy's deductible is reasonable;
2. An insurer provides adequate notice of cancellation;
3. Terms and conditions of the policy, with respect to payment per occurrence or per loss and aggregate limits, are adequate to protect interest in collateral;
4. The policy complies with applicable state insurance laws; and
5. The insurer has the financial solvency, strength, and ability to satisfy claims.

Given the variables involved in reviewing and accepting private flood insurance, lenders should ensure there are appropriate controls in place, including procedures and training for all applicable personnel.

Force Placement in Section XVII

Force Placement 8: In the July 2020 Proposed Questions and Answers, the Agencies significantly revised this Q&A to more fully discuss the minimum amount of flood insurance coverage that is statutorily required and to illustrate this point through a hypothetical example. The proposed answer stated if the outstanding principal balance is the basis for the minimum amount of required flood insurance, the lender must ensure that the force-placed policy amount covers the existing loan balance plus any additional force-placed premiums and fees that will be added to the loan balance.

Minimum: The final Q&A reiterates the Regulation that states the minimum amount of flood

insurance required "must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act." Therefore, if the outstanding principal balance is the basis for the minimum amount of required flood insurance, the lender must ensure that the force-placed policy amount covers the outstanding principal balance plus any additional force-placed premium and fees capitalized into the outstanding principal balance.

Q&A Force Placement 10: If the lender intends to capitalize the premium for the force-placed policy into the outstanding principal balance, the lender must ensure that the policy is issued in an amount sufficient to cover the anticipated higher outstanding principal balance, including the force-placed policy premium, even if the capitalization of the force-placed premium is not considered a triggering event.

Force Placement 9: A lender, or a servicer acting on its behalf, may force place flood insurance and charge the borrower for the cost of premiums and fees incurred by the lender or servicer in purchasing the flood insurance on the borrower's behalf at any time starting from the date on which flood insurance coverage lapsed or did not provide a sufficient coverage amount. The lender or servicer would not have to wait 45 days after providing notification to force place insurance.

Summary

As noted in ABA's staff analysis, even with the new Q&As and commentary, there is still uncertainty in some areas, which we hope will be addressed by the Agencies in the near future.

With 19 categories, 67 new and 38 revised questions and answers, lenders should become familiar with the guidance and update procedures and training material, as necessary.

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ABA MEMBER RESOURCES

Final Interagency Questions & Answers Regarding Flood Insurance: [aba.com/advocacy/policy-analysis/final-interagency-qa-flood](https://www.aba.com/advocacy/policy-analysis/final-interagency-qa-flood)

Flood Insurance: [aba.com/banking-topics/consumer-banking/insurance/flood-insurance](https://www.aba.com/banking-topics/consumer-banking/insurance/flood-insurance)