

Guidance on the Lapse of FEMA's Authority to Issue Flood Insurance Contracts

This guidance assists credit unions in meeting their compliance obligations under the National Flood Insurance Program (NFIP) during periods when the statutory authority of the Federal Emergency Management Agency (FEMA) to issue flood insurance contracts under the NFIP lapses. Congressional authorization of the NFIP lapsed from March 1 to 2, 2010, but was temporarily reauthorized through March 28, 2010. The NFIP again lapsed between March 28 and April 16, 2010, and was reauthorized until midnight on May 31, 2010. The NFIP again lapsed at 12:01 a.m. on June 1, 2010. This guidance applies to the current lapse period and will continue to apply if there are future lapses in the NFIP.

Background: The Flood Disaster Protection Act of 1973, (Flood Act) as amended, prohibits lenders from making, increasing, extending, or renewing loans secured by improved real property or a mobile home located in a special flood hazard area (SFHA) where federal flood insurance is available unless the building or mobile home is covered by flood insurance. See 42 U.S.C. § 4012a. This requirement is generally satisfied with coverage obtained through the NFIP.

When Congress does not reauthorize the NFIP, the authority of FEMA to issue new flood insurance policies, issue increased coverage on existing policies, and issue renewal policies expires. At that point, borrowers are not able to obtain NFIP insurance to close, renew, or increase loans secured by property located in a SFHA until the NFIP is reauthorized, except under the circumstances described below. This guidance addresses issues that may arise during a period of lapsed authorization for lenders and borrowers concerning loans that are or will be secured by property located in a SFHA.

Summary: When the NFIP is not available, credit unions may continue to make loans subject to the Flood Act and 12 C.F.R. Part 760 without flood insurance. This is not considered a violation of Part 760, but lenders must continue to make flood determinations, provide timely, complete, and accurate notices to borrowers, and comply with other parts of the flood insurance regulations. In addition, they must evaluate safety and soundness and legal risks and prudently manage those risks during the lapse period. Further, lenders need to have a system in place so that policies are obtained as soon as available following reauthorization for properties subject to mandatory flood insurance coverage.

Discussion:

Ability to Make Loans Unaffected by Lack of Authority

- Does a lapse in FEMA flood insurance authority mean that loans secured by improved real property located in special flood hazard areas may not be made by lenders?

No, it does not. Lenders are not precluded during a lapse in flood insurance authority from making loans due to a lack of NFIP flood insurance. During a lapse, a lender may legally make a loan to a borrower secured by improved real property in a SFHA without requiring the borrower to obtain flood insurance coverage. Nevertheless, a lender is not relieved of other obligations under federal flood insurance law and safety and soundness considerations cannot be disregarded. These matters are discussed in more detail below.

Retroactivity of Reauthorized Flood Insurance Policies

- Why does retroactivity matter?

If authorization is not retroactive, new or renewal policies cannot be obtained for the period when the program was not authorized, unless they were obtained before the lapse. Thus, if authorization is not provided retroactively, new policies or renewals issued after the lapse will be effective on the date of reauthorization, at the earliest. In this situation, flood losses will not be covered by the NFIP if they occur in the period subsequent to the lapse, but before the date of congressional reauthorization. Lenders should ensure borrowers understand this risk.

In the past, FEMA has stated that, if the authorization is retroactive, a flood insurance policy applied and paid for during the lapse period will be deemed effective as of the date of application and payment. In other words, retroactive application of FEMA's flood insurance authority to cover the lapse period will provide coverage in the event of a flood between the start of the lapse and the date of reauthorization for those borrowers who apply and pay for NFIP flood insurance during the lapse.

Premium Payments Received Before a Lapse

- What about flood insurance payment premiums received before an expiration of FEMA's flood insurance issuance authority?

Generally, if a completed application (including payment) or a renewal payment is received by NFIP Servicing Agents before a lapse begins, the covered property will be protected in the event of a flood after that date. Claims under existing policies and policies issued based on premiums received before the lapse will be processed without delay. Therefore, a borrower who applied for flood insurance and paid the premium

before a lapse begins will receive coverage even if the effective date of the policy is after the lapse starts. Borrowers who renewed policies before a lapse begins, which would otherwise have expired during the lapse period, will receive coverage.

Duty of Lenders to Make Flood Hazard Determinations and Provide Notice to Consumers Unaffected

- Does a lender still have to make flood hazard determinations during a lapse?

Yes, during a lapse, lenders must continue to make standard flood hazard determinations and lenders must also give borrowers the notice of special flood hazards and availability of federal disaster relief, if applicable, as required by 12 C.F.R. Part 760.

Flood Insurance Coverage During the Lapse

- What are a lender's options regarding new loans that will be affected by a lapse?

The following are options lenders may consider to address a lapse:

- Lenders may have a borrower complete the application and pay the premium, which the insurance company will hold for processing pending congressional reauthorization.
 - These applications will be processed as soon as the program is reauthorized and will be made effective to the fullest extent of that authority. If authorization is not granted, the premiums will be refunded and the new and renewal policies, which had been on hold, will not be issued.
 - Lenders should advise borrowers that remittance of the application and payment will not result in immediate NFIP coverage and cannot legally be required until reauthorization, as well as advising borrowers about the consequences of non-retroactive reauthorization.
 - Lenders should ensure borrowers with property in flood hazard areas are similarly informed of the implications of closing on a mortgage loan during a lapse.
- Lenders may determine that the risk of loss is sufficient to justify postponing closing a loan until the NFIP has been reauthorized.
- Lenders may still require that the borrower obtain private flood insurance where available; however, the cost of such insurance may be a factor that

would influence the lender or the borrower to postpone closing rather than incur a long-term obligation to address a possible short-term lapse.

- Lenders may make the loan without requiring the borrower to apply for flood insurance and pay the premium pending reauthorization, but this option poses a number of risks that lenders should carefully evaluate. Moreover, if Congress reauthorizes the NFIP, flood insurance must be obtained for these loans after the lapse, including, if necessary, by forced placement as provided in 12 C.F.R. §760.7. Before making such loans, lenders should ensure borrowers are aware of the flood insurance requirements and that force-placed insurance is typically more costly than borrower-obtained insurance. Lenders need to have a system to keep track of and identify these loans so they can ensure insurance is purchased if the NFIP is made available subsequent to closing.

Each lender remains responsible for protecting its collateral from risk in a manner appropriate to the circumstances and that ensures the overall safety and soundness of its loan portfolio. Lenders should consider the options above in the context of the overall credit quality of their loan portfolio, safe and sound lending practices, and effective risk management principles. Among the factors to consider are volume and concentration of lending in SFHAs, including loans already in a portfolio that may be subject to renewal and those to be made during a lapse period. Lenders with an elevated level of flood hazard risk should take advantage of the available options to minimize undue risk.

Renewals of Flood Insurance Policies

- What happens to renewals during a lapse?

For applications and premiums received on or after a lapse begins, FEMA generally processes all renewals as soon as the program is reauthorized. Lenders are encouraged to notify their servicers that flood insurance payment premiums may continue to be accepted during the lapse. Lenders who act as their own servicers may also continue to accept payments during the period of lapsed authority.

Alternatively, depending on the terms of the mortgage, lenders may be able to require borrowers to obtain coverage outside the NFIP, as a risk management measure.

Securitization of Mortgage Loans and the Secondary Market

- Will lenders be able to sell loans on the secondary market that do not have flood insurance coverage?

That will depend on the secondary market purchaser's decisions. Lenders should consult the purchaser about eligibility requirements and post closing obligations before closing a loan affected by this problem.

Federal Housing Authority (FHA) and Veterans Administration (VA) Loans

- Will lenders be able to make FHA and VA loans and other federally guaranteed or insured loans during a lapse?

Lenders should consult with FHA, VA or other federal guarantee agencies, as appropriate.

Agency Flood Insurance Enforcement

- Will credit unions violate 12 C.F.R. Part 760 by not obtaining flood insurance coverage of loans made during a lapse in the NFIP statutory authority?

No, but credit unions must still meet other requirements under the flood rule and, upon reauthorization, will have to obtain coverage.

The flood insurance rule defines a "designated loan" as a loan secured by a building or a mobile home that is located or to be located in a SFHA in which flood insurance is available under the NFIP. Because no flood insurance will be available under the NFIP during a lapse, credit unions will not be in violation of the prohibition against making loans without flood insurance coverage during that period.

Lenders, however, must still make flood determinations, provide timely, complete, and accurate notices to borrowers, and comply with other parts of the flood insurance regulations that have not lapsed. Moreover, lenders must carefully evaluate safety and soundness risks and prudently manage those risks during the lapse period. Upon reauthorization, flood insurance coverage must be obtained for any loan where it would have been required but for the lapse in FEMA authority. If necessary, this must be accomplished through forced placement of flood insurance by the lender. Failure to obtain insurance after it becomes available would constitute a violation of Part 760.