



OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Lapse in Flood Insurance
Authority

TO: Chief Executive Officers and Compliance Officers of All National Banks and All Examining Personnel

SUBJECT: Lapse of FEMA Authority to Issue Flood Insurance Contracts

This letter provides guidance to assist national banks in dealing with the period following January 1, 2003, during which the authority of the Federal Emergency Management Agency (FEMA) to issue flood insurance contracts under the National Flood Insurance Program (the NFIP) will lapse. This guidance has been developed in consultation with the other federal supervisory agencies to ensure a consistent approach to this issue.

Background: The Flood Disaster Protection Act of 1973, 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 USC 4012a. This requirement is generally satisfied with coverage obtained through the NFIP.

The 107th Congress adjourned at the end of November without extending the statutory authority in the National Flood Insurance Act of 1968 to issue flood insurance policies under the NFIP. As a result, the authority of FEMA to issue new flood insurance policies, issue increased coverage on existing policies, and issue renewal policies will expire on December 31, 2002. Borrowers, therefore, will not be able to obtain NFIP insurance for loans secured by property located in an SFHA that close after December 31 (or renew or increase existing policies after December 31) until the NFIP is reauthorized, except under the circumstances described below.

FEMA has indicated that it expects the new Congress to reauthorize the NFIP shortly after it convenes on January 7, 2003, and that the reauthorization will likely be made retroactive to January 1. However, FEMA also has indicated that it cannot guarantee that Congress will reauthorize the NFIP, or that reauthorization will be given retroactive effect. This letter contains informal guidance on issues that may arise during this period of lapsed authorization for lenders and borrowers concerning loans that are or will be secured by property located in an SFHA.

Summary: National banks may continue to make loans subject to the NFIP/12 CFR 22 without flood insurance during the period NFIP is not available. Such lending does not violate part 22. However, national banks must continue to make flood determinations, provide timely, complete, and accurate notices to borrowers, comply with other parts of the flood insurance regulations, and evaluate safety and soundness risks and prudently manage those risks during the lapse period. Further, national banks should have a system in place to ensure that policies are obtained

as soon as available following reauthorization for properties that are subject to mandatory flood insurance coverage.

The following discussion provides guidance to assist national banks (hereinafter, “lenders”) in dealing with the period during which the authority to issue flood insurance contracts under the NFIP has lapsed.

Discussion:

Ability to Make Loans Unaffected by Lack of Authority

- Does the lapse in FEMA flood insurance authority mean that loans secured by improved real property located in flood hazard areas may not be made by lenders once the FEMA authority expires at year-end 2002?

No, it does not. Lenders are not precluded during the lapse in flood insurance authority from making loans due to a lack of NFIP flood insurance.

FEMA has taken the position in a letter to the federal financial institution regulatory agencies, dated December 12, 2002, that during the lapse in NFIP flood authorization, flood insurance will not be available under NFIP.¹ A copy of the FEMA document is attached to this letter. During such time that flood insurance is unavailable under the NFIP, a lender may legally make a loan to a borrower secured by improved real property in a flood hazard area without requiring the borrower to obtain flood insurance coverage.

This does not mean, however, that a lender is relieved of other obligations under federal flood insurance law nor does it mean that safety and soundness considerations can be disregarded. (Both of these matters are dealt with in more detail below.)

- How long will this situation last?

FEMA is actively working with Congress to provide flood insurance reauthorization retroactive to January 1, 2003. FEMA has submitted model legislation that would accomplish this. FEMA does not know whether or how long it will take for Congress to act after it convenes in January; nor can FEMA affirmatively state that any renewal will be made retroactive.

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 are obtained prior to January 1, 2003. Thus, if authorization is not provided retroactively, the earliest date that new policies or renewals after the lapse would be effective would be the date of reauthorization. In this situation, flood

¹ The December 12 letter from FEMA contains a “Notice 3” regarding “New Business or Coverage Increase Endorsements.” Previously, on November 25, FEMA issued Notices 1 and 2 regarding renewals, which are available through FEMA, <http://bsa.nfipstat.com/wyobull/w-02082.pdf>. In addition, FEMA has issued Frequently Asked Questions (FAQ) on the lapsed insurance authority, which are also available through FEMA, <http://www.fema.gov/nfip/custfaq.htm>.

loss sustained would not be covered by the NFIP if the loss occurred in the period subsequent to the lapse and prior to the date of Congressional reauthorization.

If the authorization IS retroactive, according to FEMA, a flood insurance policy applied and paid for during the lapse period prior to reauthorization will be deemed effective as of the date of application and payment. In other words, retroactive application of FEMA flood insurance authority to cover the lapse period will provide coverage in the event of a flood between January 1 and the date of reauthorization for those borrowers who apply and pay for NFIP flood insurance during the lapse.

Premium Payments Received Prior to January 1, 2003

- ❑ What about flood insurance premium payments that are received before the expiration of FEMA's flood insurance issuance authority?

FEMA has stated in its letter of December 12 that if a completed application (including payment) or a renewal payment is received by NFIP servicing agents ON OR BEFORE December 31, the covered property will be protected in the event of a flood after that date. FEMA further states that claims under existing policies and policies issued based on premiums received prior to the lapse will be processed without delay. Therefore, according to FEMA, a borrower who makes an application for flood insurance and pays the premium on or before December 31 will receive coverage even if the effective date of the policy is after January 1, 2003.

This also applies to borrowers who renew policies on or before December 31, which would otherwise expire during the lapse period. Accordingly, to the extent possible, lenders are urged to encourage borrowers to complete applications for NFIP insurance and pay premiums before December 31.

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

- ❑ Do I still have to make flood hazard determinations?

Yes, you must continue to make standard flood hazard determinations and you must also give borrowers the notice of special flood hazards and availability of federal disaster relief, if applicable, as required by 12 CFR 22.

Flood Insurance Coverage During the Lapse

- ❑ What are my options regarding new loans that will be affected by this problem?

If you know that you will be making a covered loan that will close after December 31, you should encourage the borrower to complete the application and pay the premium before that time. If the borrower does so, and the NFIP servicing agent receives it on or before December 31, the policy can be effective after December 31, regardless of the NFIP reauthorization status.

The following describes options for you to consider in addressing this situation after December 31:

- FEMA has stated that you may have the borrower complete the application and pay the premium, which will be held for processing pending Congressional reauthorization by the insurance company (see attached FEMA letter). FEMA indicates that these applications will be processed as soon as the program is reauthorized and will be made effective to the fullest extent of that authority. FEMA has further stated that, if authorization is not granted within a reasonable period of time after Congress convenes, the premiums will be refunded and the new and renewal policies held in abeyance will not be issued. Banks should advise their 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 the consequences of nonretroactive reauthorization. FEMA has provided standard language in the form of a notice for flood insurance agents to provide to borrowers regarding availability of insurance during this period. A copy of the notice is attached. You should ensure that borrowers with property in flood hazard areas are similarly informed of the implications of closing on a mortgage loan during this period.
- You may determine that the risk of loss is sufficient to justify postponing closing the loan until such time as the NFIP has been reauthorized.
- You 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 you or the borrower to postpone closing rather than incur a long-term obligation to address a short-term lapse.
- You may make the loan without requiring the borrower to apply for flood insurance and pay the premium pending reauthorization. However, this option poses a number of risks that should be carefully evaluated. Moreover, if Congress reauthorizes the NFIP, the agencies expect that flood insurance will be obtained for these loans, including, if necessary, by forced placement as provided in 12 CFR 22.7, "Forced placement of flood insurance." Before making loans in such circumstances, you should ensure that borrowers are aware of the flood insurance requirements and that forced placed insurance is typically more costly than borrower-obtained insurance. You should also have a system to identify these loans so that you can ensure that 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 for ensuring the overall safety and soundness of its loan portfolio. You should consider the options above in the context of the overall credit quality of your loan portfolio, safe and sound banking practices, and effective risk management principles. Among the factors to consider are your volume and concentration of lending in special flood hazard areas, including loans already in your portfolio that may be subject to renewal and those to be made during the lapse period. Lenders with an elevated level of risk of flood hazard should conduct their operations by taking advantage of the available options in a manner that minimizes undue risk.

Renewals of Flood Insurance Policies

- What happens to renewals?

The situation is similar to that of making new loans. If possible, lenders and servicers should try to accelerate the payment of renewal premiums due in the period immediately following January 1, 2003. If the NFIP servicing agents and Write Your Own (WYO) companies that act on behalf of FEMA receive such payments prior to January 1, FEMA has stated that there will be no lapse in coverage. For applications and premiums received on or after January 1, FEMA has committed to process all renewals as soon as the program is reauthorized. FEMA has provided standard notices for NFIP servicing agents and WYO companies to provide to policyholders, and suggest that these companies continue to collect premiums and hold them for processing until the time that NFIP flood insurance policies are reauthorized. Lenders are encouraged to notify their servicers that flood insurance premium payments may continue to be processed during the lapse. Lenders who act as their own servicers may also continue to process such payments during the period of lapsed authority.

Alternatively, depending on the terms of the mortgage, you 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 I be able to sell loans on the secondary market that do not have flood insurance coverage?

That will depend on the decisions of your purchaser. You should consult them about eligibility requirements and any related post-closing obligations before closing a loan affected by this problem.

The Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae), principal purchasers of securitized mortgages on the secondary market, have issued announcements that set forth their policies on flood insurance for loans during the lapse period. A copy of Freddie Mac's document may be obtained at <http://www.freddiemac.com/sell/selnews/fyam2.html>. Fannie Mae's document may be obtained at <http://www.efanniemae.com/singlefamily/pdf/02-14.pdf>.

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

- Will I be able to make FHA and VA loans, and other federally guaranteed or insured loans?

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

Agency Flood Insurance Enforcement

- Will my financial institution violate Part 22 by not obtaining flood insurance coverage of loans made while the NFIP statutory authority has lapsed?

No. 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 special flood hazard area in which flood insurance is available under the NFIP. Because no flood insurance will be available under the

NFIP during the lapse, your institution will not be in violation of the prohibition against making loans without flood insurance coverage during that period.

You, 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, your bank must carefully evaluate safety and soundness risks and prudently manage those risks during the lapse period. The OCC will notify national banks of any Congressional action to reauthorize NFIP. Upon such 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 would constitute a violation of the flood rule.

Questions concerning this advisory letter may be directed to Carol Workman, compliance specialist, Compliance Division at (202) 874-4428; or Margaret Hesse, special counsel, Community and Consumer Law Division at (202) 874-5750.

David G. Hammaker
Deputy Comptroller for Compliance

Attachment:

FEMA letter of December 12, 2002, to the federal financial institution regulatory agencies concerning the lapse in flood insurance authority

Federal Emergency Management Agency
Washington, D.C. 20472

December 12, 2002

Michael Bylsma
Director, Consumer Law
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Mr. Bylsma:

As you may be aware, the authority for certain provisions of the National Flood Insurance Program (“NFIP”), including 42 U.S.C. §4026 relating to the issuance of new policies, expires on December 31, 2002.¹ With the 107th Congress adjourned, reauthorization cannot be accomplished before the 108th Congress convenes in January 2003. I want you to know that FEMA is doing everything it can to resolve this issue expeditiously and with as little disruption of insurance operations as possible. We are also working with our insurance partners to prepare for this situation.

FEMA has been asked whether the requirements of 42 U.S.C. §4012a relating to mandatory purchase of flood insurance are affected by the lapse of authority to issue new insurance contracts. It is our position that during the lapse, flood insurance is not made available under the National Flood Insurance Program for purposes of §4012a.

In anticipation that this period without authority to issue new policies will be brief, FEMA has provided direction to its NFIP Servicing Agent contractor that issues flood policies for the government, and provided guidance to the Write Your Own companies, that any premium payments for new and renewal policies received after December 31, 2002, are to be held and policies not issued until authority to enter into new flood insurance contracts has been reestablished. The Servicing Agent and the companies should hold applications received in the ordinary course of business and records of policy application and premium receipt dates are to be maintained by them. We have provided a notice, attached hereto as Notice 3, for distribution to applicants by the NFIP Servicing Agent and recommended for use by Write Your Own companies. FEMA is actively working with Congress to provide reauthorization retroactively to January 1, 2003. Such retroactive reauthorization has been done in similar circumstances for the NFIP in the past. Of course, FEMA has no guarantee that retroactive reauthorization will occur.

If retroactive reauthorization does occur as expected, the NFIP intends to honor all effective dates for flood insurance policy coverage based on the normal application and premium receipt processes and requirements, even though the issuance of the flood policy was held in abeyance pending the congressional action. This includes both starting applicable flood insurance waiting periods during the authority hiatus period and putting a flood policy in force as of a qualifying loan settlement date during the hiatus period. Thus any claims for flood damage that occurs during the period in which FEMA’s authority has lapsed would be appropriately honored once authority is reestablished and made retroactive.

¹ Pub. L. 107-73, Title III, November 26, 2001, 115 Stat.689.

If authorization is not provided retroactively, then insurance coverage cannot be made effective earlier than the date of reauthorization. In addition, if authorization is not granted within a reasonable period of time after Congress convenes, the NFIP will have to refund premiums and not issue the new and renewal policies held in abeyance.

It should be noted that even with the lapse in authority, new and renewal policies for which premium is received on or before December 31, 2002, will still be issued for coverage that will become effective after December 31. This includes premium payments made by lenders from escrow accounts. Thus claims for existing policies and policies issued based on premiums received prior to the hiatus, will be processed without delay.

Most authorities under the NFIP continue without lapse after December 31, 2002. For example, claims will be paid as noted above, flood maps will still be in effect for determinations and floodplain management, and floodplain management requirements will still be in force.

Finally, I ask that you devote the necessary resources to prepare for this occurrence and to take appropriate action to minimize the impact upon consumers and your stakeholders.

To the extent possible, FEMA will provide technical assistance and support in working through this period. You or members of your staff may contact me or Howard Leikin, Deputy Administrator for Insurance, at (202) 646-2781, regarding this matter.

Sincerely,

Anthony S. Lowe
Administrator
Federal Insurance and Mitigation Administration

cc: Virginia Hagan, Office of the Comptroller of the Currency
John D. Hawke, Jr., Office of the Comptroller of the Currency
Carol Workman, Office of the Comptroller of the Currency
Margaret Hesse, Office of the Comptroller of the Currency

Notice 3
[New Business or Coverage Increase Endorsements]

You are applying for flood insurance or an increase in coverage from the National Flood Insurance Program (NFIP), a government insurance program that is administered by the Federal Emergency Management Agency (FEMA).

The NFIP operates under authority from Congress that has to be renewed periodically. As of December 31, 2002, that authority has expired and is awaiting Congressional renewal. Until such renewal is granted, the premium you are paying will be held by FEMA.

FEMA will hold your premium in order that your policy or coverage increase can go into effect at the earliest date, consistent with the receipt of premium and waiting period rules of the NFIP and the extension of authority for the NFIP. For applications made in connection with a mortgage loan, if, as FEMA has requested, renewal of the authority to issue flood insurance policies under the NFIP is granted retroactively, your policy will be issued effective as of the date of the closing of your loan. If Congressional renewal is granted retroactively, any claim for insurable losses you suffer from that effective date onward will be honored by the NFIP, even if the authority is granted after the date of such losses.

If Congressional renewal is not granted within a reasonable period after Congress reconvenes, FEMA will refund your premium. In such an event, and provided that you do not purchase alternative flood coverage, you will not have had the protection of flood insurance during this period and will be at risk for any damage to the property caused by flood.

Please note, you are under no obligation to purchase your flood insurance from the NFIP. You may choose to purchase flood insurance elsewhere if other providers are available in your area. If your purchase of insurance is due to your lender's requirement, then any other provider is subject to your lender's approval.