

# Client Alert

February 2019

## New Final Rule Offers Welcome Relief and Guidance on Private Flood Insurance Requirements

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the National Credit Union Administration (the Agencies) recently released a final rule offering significant relief and guidance to institutions in connection with accepting private flood insurance for properties located in special flood hazard areas that are subject to the Biggert-Waters Act (the Final Rule). Pursuant to the Final Rule, the Agencies seek to reduce the burden of compliance on institutions and increase the availability of private flood insurance policies by providing broader discretion to institutions as to the policies and plans that can be accepted.

### Background

The National Flood Insurance Act of 1968 (the NFIA) was enacted to ensure adequate coverage of federally subsidized flood insurance on improved real estate or a mobile home located, or to be located, in a special flood hazard area (SFHA) in a community participating in the National Flood Insurance Program (NFIP). The NFIA was extended to federally regulated financial institutions with the enactment of the Flood Disaster Protection Act of 1973 (the FDPA). Substantial changes were made to both the NFIA and FDPA through the enactment of the National Flood Insurance Reform Act of 1994 (the NFIRA). In 2012, additional significant amendments to the NFIRA were made through enactment of the Biggert-Waters Flood Insurance Reform and Modernization Act (Biggert-Waters Act).

The Biggert-Waters Act enhanced concerns from a financial institution compliance perspective. Such concerns included the amendments that: (i) increased the civil money penalties to \$2,000 per flood violation and removed the annual penalty maximum; (ii) required regulated lending institutions<sup>1</sup> to escrow accounts for flood insurance premiums for all new and existing residential real estate and mobile home-secured loans within a flood zone, unless the institution falls into an exception; (iii) required regulated lending institutions to accept private flood insurance to satisfy the mandatory purchase requirements and notify borrowers of the availability of flood insurance; and (iv) amended the forced placed insurance requirements and procedures. In other words, by coupling these new technical requirements with significant civil money penalties, the Biggert-Waters Act made flood insurance a heightened compliance concern for many financial institutions.

Since its inception, the “private flood insurance” requirement in the Biggert-Waters Act has been a source of challenge for institutions. The Biggert-Waters Act required that private flood insurance could only be accepted if it met the statutory definition, imposing significant hurdles on institutions in evaluating policies

---

<sup>1</sup> A “regulated lending institution” includes any “bank, savings and loan association, credit union, farm credit bank, Federal land bank association, production credit association, or similar institution subject to the supervision of a Federal entity for lending regulation.” 42 U.S.C. § 4003(a)(10). A “Federal entity for lending regulation” means the “Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the National Credit Union Administration, and the Farm Credit Administration, and with respect to a particular regulated lending institution means the entity primarily responsible for the supervision of the institution.” *Id.* § 4003(a)(5).

for potential acceptance and limiting the number of private policies that could meet the statutory standards. To provide more flexibility to institutions and permit more private insurers to provide insurance that could qualify under the Biggert-Waters Act, the Agencies sought comments regarding implementing a “discretionary acceptance provision” that would permit lenders to accept private insurance that met certain criteria, even though such insurance would not otherwise meet the strict statutory definition of private flood insurance.

In response to those comments, the Agencies adopted the Final Rule, effective July 1, 2019, amending the previous regulations for the Biggert-Waters Act. Under the Final Rule, institutions must still accept private flood insurance policies meeting the full definition of “private flood insurance.” Importantly, however, institutions now also have broader flexibility to:

1. Rely on a “streamlined compliance aid provision” to help institutions determine, without further review, that a policy meets the definition of “private flood insurance” if the policy (or an endorsement to the policy) contains the following language: “This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation.” The Agencies further clarified that “if a policy includes this statement, the regulated lending institution may rely on the statement and would not need to review the policy to determine whether it meets the definition of ‘private flood insurance.’ ”
2. Accept flood insurance policies that do not meet the full statutory definition of “private flood insurance” under a “discretionary acceptance provision,” if the policy meets other conditions.
3. Exercise discretion when accepting non-traditional flood coverage issued by “mutual aid societies.”

## Conditions to Accept Private Insurance Outside the Statutory Definition

In addition to the “streamlined compliance aid,” the Final Rule also seeks to alleviate compliance challenges for institutions by including a “discretionary acceptance provision.” Pursuant to the “discretionary acceptance provision,” institutions may accept flood insurance policies that do not meet the statutory definition of “private flood insurance,” if the policy meets the following conditions:

1. The policy must provide coverage in the amount required by the flood insurance purchase requirements. Insurance is required under the Biggert-Waters Act for the term of the loan “in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular type of property, whichever is less.”<sup>2</sup>
2. The policy must be issued by an insurer that is licensed, admitted or otherwise approved to engage in the business of insurance by the insurance regulator of the state or jurisdiction in which the property to be insured is located; or in the case of a policy of difference in conditions, multiple peril, all risk or other blanket coverage insuring nonresidential commercial property, is issued by a surplus lines insurer recognized, or not disapproved, by the insurance regulator of the state or jurisdiction where the property to be insured is located.
3. The policy must cover both the mortgagor and mortgagee as loss payees, except in the case of a policy that is provided by a condominium association, cooperative, homeowners association or other applicable group and for which the premium is paid by the condominium association, cooperative, homeowners association or other applicable group as a common expense.

---

<sup>2</sup> 42 U.S.C. § 4012a(b)(1)(A).

4. The policy must provide sufficient protection of the designated loan, consistent with general safety and soundness principles, and the institution must document its conclusion regarding sufficiency of the protection of the loan in writing.

In evaluating whether a flood insurance policy provides “sufficient protection,” the Agencies provide the following non-exhaustive factors that an institution could consider:

- Whether the policy’s deductibles are reasonable given the borrower’s financial condition;
- Whether the insurer provides adequate notice of cancellation to the mortgagor and mortgagee to ensure timely force placed insurance, if necessary;
- Whether the terms and conditions of the flood insurance policy with respect to payment per occurrence or per loss and aggregate limits are adequate to protect the institution’s interest in the collateral;
- Whether the flood insurance policy complies with applicable state insurance laws; and
- Whether the private insurance company has the solvency, strength and ability to satisfy claims.

### **Conditions to Accept Plans Issued by a Mutual Aid Society**

The Final Rule also permits institutions to accept a plan issued by mutual aid societies. The Final Rule defines a “mutual aid society” as an organization (1) whose members share a common religious, charitable, education or fraternal bond, (2) that covers losses caused by damage to members’ property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond and (3) that has a demonstrated history of fulfilling the terms of agreements to cover losses to members’ property caused by flooding.

Institutions may accept a plan issued by a mutual aid society if: (1) the regulated lending institution’s primary federal supervisory agency has determined that such plans qualify as flood insurance for purposes of this Act; (2) the plan must provide coverage in the amount required by the flood insurance purchase requirement; (3) the plan must cover both the mortgagor(s) and the mortgagee(s) as loss payees; and (4) the plan must provide sufficient protection of the designated loan, consistent with general safety and soundness principles, and the regulated lending institution must document its conclusion regarding sufficiency of the protection of the loan in writing.

### **Action Steps**

The Final Rule provides significant relief and guidance to institutions by allowing greater flexibility in what private policies or plans can be accepted for properties in special flood hazard areas when certain conditions are met. In advance of the July 1, 2019, effective date for the Final Rule, it is thus essential that institutions carefully evaluate their compliance measures and begin revamping their existing flood insurance policies and procedures to address the requirements of the Final Rule.

As part of this process, institutions should take the time now to revise their policies and procedures to address the alternative avenues to accept private insurance outside the statutory definition through the “streamlined compliance aid,” the discretionary acceptance requirements and the conditions to accept plans issued by mutual aid societies. A critical component of the revised policies and procedures will be addressing the express requirement that institutions must document their conclusion that a private insurance policy or mutual aid society plan “sufficiently protects” the designated loan. This means that institutions must proactively incorporate the non-exhaustive factors that the Agencies have approved into their policies and procedures, and ensure that the policies and procedures require careful evaluation and documentation of the application of these factors in reaching any conclusion.

Even in the midst of providing regulatory relief, it has been our experience that the Agencies often take a hyper-technical view on flood insurance compliance issues and can be quick to assess civil money penalties if there is a perceived pattern or practice of violations. While we have been successful in defending many institutions against such alleged violations without the imposition of penalties, the better course is to proactively implement comprehensive policies and procedures on the front end. Institutions should seek guidance from counsel in enhancing their flood insurance policies and procedures early in the process to ensure that the Final Rule provides long-awaited relief and not new compliance hurdles.

### Authors

**Abigail M. Lyle**  
alyle@HuntonAK.com

**Nikki Skolnekovich**  
nskolnekovich@HuntonAK.com

*Abigail Lyle and Nikki Skolnekovich are members of the Consumer Financial Compliance and Litigation practice group at Hunton Andrews Kurth LLP. This article presents the views of Ms. Lyle and Ms. Skolnekovich and does not necessarily reflect those of Hunton Andrews Kurth or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article. Ms. Lyle writes and speaks frequently on topics of interest to financial institutions, and regularly and regularly advises and defends institutions in connection with flood insurance issues. She may be reached at (214) 979-8219 or alyle@huntonak.com.*

© 2019 Hunton Andrews Kurth LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.