



Office of Thrift Supervision
Department of the Treasury

Scott M. Albinson
Managing Director

1700 G Street, N.W., Washington, DC 20552 • (202) 906-7984

December 20, 2002

MEMORANDUM FOR: CHIEF EXECUTIVE OFFICERS

FROM:

Scott M. Albinson

SUBJECT:

Lapse of FEMA Authority to Issue Flood Insurance Contracts

This memorandum provides guidance to assist thrifts 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.

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 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.

The 107th Congress adjourned at the end of November 2002 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 a special flood hazard area ("SFHA") that close after December 31, 2002 (or renew or increase existing policies after December 31, 2002) 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, 2003. Nevertheless, there are no guarantees 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 a SFHA.

Summary: Thrifts may continue to make loans subject to the NFIP/12 C.F.R. Part 572 without flood insurance during the period NFIP is not available. Such lending does not violate Part 572. However, these institutions 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, regulated institutions 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 thrifts (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 special 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 retroactively to January 1, 2003. FEMA has submitted model legislation that would accomplish this. We do not know whether or how long it will take for Congress to act after it convenes in January; nor can we affirmatively state that any renewal will be made retroactive.

¹ The December 12, 2002 letter from FEMA contains a “Notice 3” regarding “New Business or Coverage Increase Endorsements.” Previously, on November 25, 2002, 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 is available through FEMA (<http://www.fema.gov/nfip/custfaq.htm>).

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 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 payment premiums that are received before the expiration of FEMA's flood insurance issuance authority?

FEMA has stated in its letter of December 12, 2002, that if a completed application (including payment) or a renewal payment is received by NFIP Servicing Agents ON OR BEFORE December 31, 2002, 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, 2002, will receive coverage even if the effective date of the policy is after January 1, 2003.

This also applies to borrowers that renew policies on or before December 31, 2002, that 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, 2002.

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 C.F.R. Part 572.

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, 2002, 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, 2002, the policy can be effective after December 31, regardless of the NFIP reauthorization status.

The following describes options for you to consider to address this situation after December 31, 2002:

- FEMA has stated that you can 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 guidance). 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 non-retroactive 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 possible 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

force-placement as provided in 12 C.F.R. § 572.7, "Forced placement of flood insurance." Before making such loans, you should ensure that borrowers are aware of the flood insurance requirements and that force-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, 2003, FEMA has stated that there will be no lapse in coverage. For applications and premiums received on or after January 1, 2003, 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 payment premiums 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 post closing obligations before closing a loan affected by this problem.

The Federal Home Loan Mortgage Corporation ("Freddie Mac"), a principal purchaser of securitized mortgages on the secondary market, issued an announcement on December 16, 2002 that set forth its policies on flood insurance for loans during the lapse period. A copy of the announcement is available on Freddie Mac's website.

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 agency, as appropriate.

Agency Flood Insurance Enforcement

- Will my financial institution violate Part 572 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 federal financial institution regulatory agencies will notify financial institutions 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 your regional OTS office.

Attachments:

FEMA Letter of December 12, 2002 to the Federal Financial Institution Regulatory Agencies Concerning the Lapse in Flood Insurance Authority

Freddie Mac Announcement of December 16, 2002:

<http://www.freddiemac.com/sell/selnews/fyam2.html> (Electronic version)



Federal Emergency Management Agency

Washington, D.C. 20472

W-02084

December 12, 2002

MEMORANDUM FOR: WYO Principal Coordinators

FROM:

Anthony S. Lowe

Administrator

Federal Insurance and Mitigation Administration

SUBJECT:

Lapse of Statutory Authority for the NFIP

My memorandum of November 25, 2002, informed you the statutory authority to issue flood insurance policies pursuant to the NFIP ends December 31, 2002.

Attached is a memorandum dated December 12, 2002, instructing the NFIP Servicing Agent how to proceed in regard to handling new applications and increased coverage requests received during the hiatus in statutory authority. We similarly suggest you consider ways to avoid costly, confusing, and inconvenient return of premium payments to your policyholders.

During the hiatus period, since we understand that WYO companies will work to hold premiums, normal cash receipts will be affected. WYO companies should plan to pay refunds, all claims, and claims related expenses from letter of credit drawdowns rather than from any premium receipts that may be deposited in their restricted accounts during the hiatus.

We will inform you when Congress has extended the NFIP statutory authority.


Enclosures



Federal Emergency Management Agency
Washington, D.C. 20472

December 12, 2002

MEMORANDUM FOR: Laurie Michie
Project Officer
NFIP Servicing Agent Contract

FROM: Anthony S. Lowe 
Administrator
Federal Insurance and Mitigation Administration

SUBJECT: Lapse of Statutory Authority for the NFIP

My memorandum of November 25, 2002, informed you that the statutory authority to issue flood insurance policies pursuant to the NFIP ends December 31, 2002.

We expect that the new Congress will re-authorize the NFIP early in the term, but there will be a hiatus where we will not be able to issue new policies, issue increased coverage on existing policies, or issue renewal policies. We also expect that when Congress re-authorizes the NFIP, it will be retroactive to January 1, 2003.

My prior memorandum included two notices that were to be sent to policyholders whose policies were expiring on and after January 1, 2003. Enclosed is an additional notice that the NFIP servicing agent is to send to applicants whose new business applications or increased coverage endorsement requests are received on and after January 1, 2003.

We want to emphasize that even during the hiatus, claims for losses occurring during the hiatus, on existing policies and on policies issued based on premiums that were received prior to the hiatus, are to be processed and paid without delay.

We will inform you when Congress has extended the NFIP statutory authority.

Enclosure

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.