

## INSIGHTS

## Parting the Waters of Uncertainty for Private Flood Insurance

Publications

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A final interagency rule taking effect on July 1, 2019, provides federally regulated lending institutions with eagerly awaited guidance concerning private flood insurance for improved properties located in special flood hazard areas. Pursuant to the final rule, the OCC, Federal Reserve, FDIC, Farm Credit Administration and National Credit Union Administration seek to increase availability and use of private flood insurance coverage by instructing regulated lending institutions to accept certain private flood insurance, and by giving regulated lending institutions greater discretion as to the types of private flood insurance that can be accepted.

Notably, under the final rule, regulated lending institutions may determine that a private policy provides acceptable flood insurance coverage 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 final rule, therefore, provides significant relief and guidance to federally regulated lending institutions by allowing greater flexibility in what private policies can be accepted for improved properties in SFHAs.

### BACKGROUND AND OVERVIEW

The National Flood Insurance Act of 1968, Flood Disaster Protection Act of 1973 and National Flood Insurance Reform Act of 1994 require flood insurance on real estate or mobile homes located or to be located in a SFHA in a community participating in the National Flood Insurance Program that secure loans made, increased, renewed or extended by a federally regulated lending institution. These laws specify the amount of insurance that must be purchased and also require such insurance be maintained for the term of the loan. The Biggert-Waters Flood Insurance Reform and Modernization Act of 2012 requires, among other things, that the agencies adopt regulations directing regulated lending institutions to accept insurance that meets the statutory definition of "private flood insurance" in the Biggert-Waters Act in lieu of NFIP flood insurance.

Earlier this year, the agencies issued a final rule amending their regulations governing loans secured by properties in SFHAs to implement provisions of the Biggert-Waters Act concerning private flood insurance. The final rule takes effect on July 1, 2019, and institutes the following:

- Regulated lending institutions must accept private flood insurance policies that meet the statutory definition of "private flood insurance" in the Biggert-Waters Act.

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- Regulated lending institutions may rely on a “streamlined compliance aid provision” to determine, without further review, that a policy meets the definition of “private flood insurance” under the Biggert-Waters Act 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.”
- Regulated lending institutions may accept private policies that do not meet the statutory definition of “private flood insurance” in the Biggert-Waters Act under a “discretionary acceptance provision” subject to certain restrictions and regulated lending institutions’ documentation that the policies offer “sufficient protection for a designated loan, consistent with general safety and soundness principles.”
- Regulated lending institutions may accept flood coverage issued by “mutual aid societies” subject to certain conditions.

## TERMS FOR ACCEPTANCE OF PRIVATE POLICIES

To qualify as “private flood insurance” under the Biggert-Waters Act, a policy must be issued by an insurance company that meets certain conditions and must provide flood insurance coverage at least as broad as the coverage provided under a standard flood insurance policy issued under the NFIP for the same type of property. Specifically, the final rule defines “private flood insurance” as an insurance policy that:

- Is issued by an insurance company 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
  - Recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the state or jurisdiction in which the property to be insured is located in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property.
- Provides flood insurance coverage that is “at least as broad as” the coverage provided under a SFIP for the same type of property, including when considering deductibles, exclusions, and conditions offered by the insurer, meaning the policy must, at a minimum:
  - Define the term “flood” to include the events defined as a “flood” in an SFIP;
  - Contain the coverage and provisions specified in an SFIP;
  - Contain deductibles no higher than the specified NFIP maximum, and include similar non-applicability provisions as under an SFIP, for any total policy coverage amount up to the maximum available under the NFIP at the time the policy is provided to the regulated lending institution;
  - Provide coverage for direct physical loss caused by a flood and may only exclude other causes of loss that are excluded in an SFIP; and
  - Not contain conditions that narrow the coverage provided in an SFIP.
- Includes all of the following:
  - A requirement for the insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to the insured and the institution that made the designated loan or the servicer acting on its behalf;

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- Information about the availability of flood insurance coverage under the NFIP;
- A mortgage interest clause similar to the clause contained in an SFIP; and
- A provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy.
- Contains cancellation provisions that are as restrictive as the provisions contained in an SFIP.

Under the final rule, on and after July 1, 2019, a regulated lending institution must accept a private policy that meets all of the above requirements in satisfaction of the flood insurance purchase requirement. In a June 18, 2019, webinar, speakers from the agencies also added that regulated lending institutions may decide to only accept private flood insurance policies that comply with the mandatory acceptance provision. The speakers further stated that the agencies are updating their examination procedures, as appropriate, to address the requirements of the final rule, including the “at least as broad as” requirement.

### THE STREAMLINED COMPLIANCE AID PROVISION

Pursuant to the final rule, regulated lending institutions have flexibility to determine that a policy meets the definition of “private flood insurance” if the policy or an endorsement 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 clarify that “if a policy includes [the above] 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.’” However, the final rule does not require insurance companies to include such a statement in a private policy, and a regulated lending institution cannot reject a private policy only because the statement is not included in a private policy. In the June 18, 2019, webinar, agency representatives also added that a lender is not required to accept a private policy merely because the policy contains the language of the compliance aid provision.

### THE DISCRETIONARY ACCEPTANCE PROVISION

Regulated lending institutions also have flexibility to accept flood insurance policies that do not meet the full statutory definition of “private flood insurance” under the Biggert-Waters Act pursuant to a “discretionary acceptance provision” in the final rule. Specifically, regulated lending institutions may accept private flood policies if such policies:

- Provide coverage as required by the Flood Insurance Purchase Requirement;
- Are 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.

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- Cover both the lender(s) and borrower(s) 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; and
- Provide sufficient protection of the designated loan, consistent with general safety and soundness principles, and institutions document their conclusion regarding sufficiency of protection of loans 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.

In the June 18 webinar, speakers from the agencies were asked how a regulated lending institution can evaluate whether or not an insurance company has the financial solvency, strength and ability to satisfy claims. The speakers responded by stating that if a lender has concerns about an insurance company’s financial solvency, strength, and ability to satisfy claims, the lender should contact the state insurance regulator in the state where the relevant property is located for additional information about the insurance company and can rely on the licensing or other review process used by the state insurance regulator to evaluate the insurance company’s financial solvency, strength and ability to satisfy claims.

## PRIVATE FLOOD INSURANCE ISSUED BY MUTUAL AID SOCIETIES

Finally, regulated lending institutions may accept flood coverage issued by “mutual aid societies” under certain conditions pursuant to the final rule. The final rule defines a “mutual aid society” as an organization: whose members share a common religious, charitable, educational, or fraternal bond; 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 that has a demonstrated history of fulfilling the terms of agreements to cover losses to members’ property caused by flooding.

In particular, a regulated lending institution may accept flood coverage issued by a mutual aid society if:

- The regulated lending institution’s primary federal supervisory agency has determined that the coverage qualifies as flood insurance for the Biggert-Waters Act;
- Coverage is provided in the amount required by the flood insurance purchase requirement;

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- The lender(s) and borrower(s) are covered as loss payees; and
- The regulated lending institution documents in writing its determination that the coverage provides sufficient protection of the designated loan, consistent with general safety and soundness principles.

The final rule does not require lending institutions to accept coverage issued by mutual aid societies.

The agencies' final rule regarding private flood insurance provides much needed guidance and greater flexibility to regulated lending institutions, and permits additional private insurers to provide flood insurance coverage that qualifies under the Biggert-Waters Act. Regulated lending institutions should evaluate their compliance measures now to ensure that such measures are aligned with the final rule.

Original *ABA Banking Journal* publication can be found [here](#).