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Office of Thrift Supervision
Department of the Treasury

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This document and any attachments are superseded by (OCC 2010-20).

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MEMORANDUM FOR: **CHIEF EXECUTIVE OFFICERS**

FROM: Montrice Godard Yakimov, Managing Director
Compliance and Consumer Protection

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SUBJECT: Lapse and Extension of FEMA Authority to Issue Flood Insurance Contracts

This memorandum provides guidance to assist thrifts in dealing with the period during which the authority of the Federal Emergency Management Agency ("FEMA") to issue flood insurance contracts under the National Flood Insurance Program (the "NFIP") lapsed (March 1-2, 2010). While temporary funding for the NFIP expired on February 26, 2010, it has now been extended to March 28, 2010. This memorandum also provides guidance that will apply if there are any future lapses in the NFIP.

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.

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 be able to obtain NFIP insurance to close, renew, or increase loans secured by property located in a special flood hazard area ("SFHA") until the NFIP is reauthorized, except under the circumstances described below. This letter contains informal guidance on 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: Thrifts may continue to make loans subject to the NFIP/12 C.F.R. Part 572 without flood insurance during a period when the NFIP is not available. Such lending does not violate Part 572. However, institutions 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 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.

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The following discussion provides guidance to assist thrifts (hereinafter, “lenders”) in dealing with a 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 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. However, flood insurance is not available under the NFIP during a lapse. During a lapse, 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 laws, nor does it mean that safety and soundness considerations can be disregarded. Both of these matters are dealt with 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 prior to 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 prior to the date of Congressional reauthorization.

  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 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 Prior to a Lapse

- *What about flood insurance payment premiums that are received before an expiration of FEMA’s flood insurance issuance authority?*

  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 prior to the lapse will be processed without delay. Therefore, a borrower who made an application for flood insurance and paid the premium on or before a lapse begins, will receive coverage even if the effective date of the policy is after the lapse starts. This also applies to borrowers who renewed policies on or before a lapse begins, that would otherwise have expired during the lapse period.

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

- *Do I still have to make flood hazard determinations during a lapse?*

  Yes, during a lapse 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 a lapse?*

The following describes options for you to consider to address a lapse:

- You can have a borrower complete the application and pay the premium, which will be held for processing pending Congressional reauthorization by the insurance company.

  — 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 held in abeyance will not be issued.

  — You 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 the consequences of non-retroactive reauthorization.

  — You should ensure that borrowers with property in flood hazard areas are similarly informed of the implications of closing on a mortgage loan during a lapse.

- 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 after a lapse, OTS expects that flood insurance will be obtained for these loans, including, if necessary, by force-placement as provided in 12 C.F.R. § 572.7. 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

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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 that ensures 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 a 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 during a lapse?*

Renewals and new loans are in a similar situation. For applications and premiums received on or after a lapse begins, FEMA processes the renewals as soon as the program is 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.

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 during a lapse?*

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

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Agency Flood Insurance Enforcement

- *Will my financial institution violate Part 572 by not obtaining flood insurance coverage of loans made during a lapse in the NFIP statutory authority?*

  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 a 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 those parts of the flood insurance regulations that have not lapsed. Moreover, you 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 572.

For more information, please contact Ekita Mitchell, Compliance Program Analyst at (202) 906-6451 or Ekita.Mitchell@ots.treas.gov, or your regional OTS office.

Attachments: FEMA Memorandum Regarding NFIP Reauthorization until March 28, 2010
Link: http://www.nfipiservice.com/stakeholder/pdf/bulletin/w-10015.pdf

FEMA Memorandum Regarding NFIP Lapse on March 28, 2010
Link: http://www.fema.gov/pdf/nfip/w_10063.pdf