ATTACHMENT B

FLOOD DISASTER PROTECTION ACT

EXAMINATION PROCEDURES

FLOOD DISASTER PROTECTION ACT

The Flood Disaster Protection Act of 1973 (FDPA)(42 U.S.C. 4003) prohibits federally regulated financial institutions from making, increasing, extending or renewing <u>any</u> loan (applicability of the FDPA is not limited to consumer loans) secured by improved real estate or a manufactured home if:

- the property securing the loan is located in an area having special flood, mudslide or flood-erosion areas, as identified by the Federal Emergency Management Agency (FEMA) and
- the community is participating in the National Flood Insurance Program (NFIP) and
- flood insurance is not purchased for the property securing the loan.

The FDPA also prohibits the use of federal financial assistance for the acquisition or construction of a structure in a special flood hazard area (SFHA) unless the community participates in the NFIP and flood insurance has been purchased. The term "federal financial assistance" includes loans, grants, guarantees, and similar forms of direct and indirect assistance from Federal agencies, such as FHA or VA mortgage insurance. For communities participating in the NFIP, the term federal financial assistance also includes coventional loans from federally insured, supervised or approved lending institutions.

The principal objectives of the FDPA are:

- To ensure that flood insurance is available at reasonable cost to owners of improved real property located in SFHA of communities that participate in the NFIP;
- To reduce or avoid future flood losses and provide a preventive alternative to massive doses of federal disaster relief funds normally made available to flood stricken areas.

FLOOD INSURANCE PROGRAMS

The FDPA expands the provisions of the original National Flood Insurance Act of 1968 (NFIA). The NFIA provisions created the National Flood Insurance Program, originally operated by the federal government through the Department of Housing and Urban Development (HUD). The program is now administered by the Federal Emergency Management Agency (FEMA). Although some flood insurance policies are underwritten by the

United States government, many policies are now written by private insurance carriers for FEMA. Direct participants of the the NFIP are state and local governments, lenders, and insurance agents.

In addition to supervising the insurance aspects of the NFIP, FEMA identifies communities with special flood-hazard areas, issues maps for those areas, helps communities qualify for the NFIP, and assists them in adopting flood plain management requirements.

Every state has appointed an agency that serves as a liason between the federal government and communities in the state for developing the NFIP. These state coordinating agencies work with FEMA to distribute program information.

Licensed property and casualty insurance agents and brokers provide the main connection between the program and the insured. Licensed agents sell flood insurance, complete the insured's application form, and follow up with the insured for renewals. They also handle claims.

There are two phases of the NFIP. Communities entering the NFIP become eligible for the sale of flood insurance in the Emergency Flood Insurance Program (Emergency Program). Under this program, insurance is provided for lower limits of coverage (first layer) at federally subsidized rates on eligible structures. Flood Hazard Boundary Maps issued in conjunction with the Emergency Program, are used to determine whether properties are located in flood plain areas having special flood or mudslide hazards.

The second phase of the NFIP is the Regular Program. A community enters the Regular program once a detailed study of the community has been completed and the Flood Insurance Rate Maps for the area have been issued by FEMA. The Regular Program provides full insurance coverage (first and second layers), Flood Insurance Rate Maps, and additional flood plain management requirements for the community. These Flood Insurance Rate Maps delineate communities by degrees of probability of flood hazard and include more specific area identification than the Flood Hazard Boundary Maps issued in conjunction with the Emergency Program. The maps indicate base flood elevations, which are elevations where there is at least a 1 percent chance of flood loss each year.

SCOPE

The FDPA expands the provisions of the NFIA by:

° Requiring flood-prone communities to participate in the NFIP as a condition of future financial assistance for flood-related damage to property.

° Requiring land use measures in certain flood-prone areas as a condition for making flood insurance available in those areas.

° Directing financial regulatory agencies to ensure that their institutions do not make loans secured by real estate or manufactured homes located, or to be located, in a SPHA if the community participates in the NFIP unless the property securing the loan has flood insurance.

° Directing financial regulatory agencies to require their institutions, as a condition to making flood-related loans, to notify the purchaser or lessee of the availability of federal disaster relief assistance and of the possibility of flood hazards.

° Directing federal agencies such as FHA and VA not to subsidize, insure, guarantee or approve any flood-related loan if the property securing the loan is located in a SFHA of a nonparticipating community.

PROPERTY ELIGIBLE FOR FLOOD INSURANCE

The NFIP covers improved real estate or manufactured homes located, or to be located, in an area that has been identified by the FEMA as having special flood hazards, including:

° Construction loans for buildings under construction;

° Condominiums or townhouses that are contiguous to the ground, capable of separate ownership and having legal description

° High-rise condominums with common ownership

° Other types of residential, industrial, commercial and agricultural buildings with any walled and roofed structure that is principally above ground and affixed to a permanent site

° Mobile homes*

° Dealers' inventories of mobile homes on foundations*

* (after October 1, 1982, mobile homes must be on a permanent foundation and anchored to resist floatation, callapse and lateral movement. Foundations may consist of poured masonry, block walls or pier or block supports, provided no weight is supported by the wheels and axles of the mobile home. Double wide mobile homes of at least 16 feet wide with an area of 600 square feet are not subject to tie down requirements, but are treated as any other building.)

Each building is insured separately, as is each manufactured home, including those in dealer inventories that are eligible for coverage. Policies for high-rise condominiums may be issued individually, as well as to the condominium owners' association. Each unit, however, is eligible for contents coverage on personal property contained within a fully enclosed structure.

Personal property insurance coverage is available for machinery, equipment, fixtures, and furnishings contained in real property or a manufactured home. Insurance coverage for on contents of basements or rooms with floor below grade on all sides may be subject to certain restrictions.

EXEMPTIONS

Types of property for which flood insurance policies are not available include: unimproved property, such as land, bridges, dams, roads, manufactured homes not on foundations, travel trailers, converted buses, and campers. In addition, property constructed or substantially improved on or after October 1, 1983 and located seaward of mean high tide, or entirely in, on, or over water is excluded from coverage. New construction or substantial improvements to property located on undeveloped coastal barriers is also excluded from coverage.

Flood insurance is not required on any state-owned property that is covered under an adequate policy of self-insurance satisfactory to FEMA. FEMA publishes and periodically revises the list of states falling within its exemption.

FLOOD INSURANCE DETERMINATION

Under the FDPA, financial institutions are responsible for determining whether property connected with a loan application is located in a special flood hazard area. If so, the financial institution must also determine whether the property is located in a community that participates in the NFIP. A financial institution may make, increase, extend or renew any direct conventional loan secured by improved real estate or a manufactured home located in a SFHA when all three of the following conditions exist:

- A flood hazard boundary map or a flood insurance rate map has been published for the community in which the property is located;
- The community in which the area is located participates in the NFIP; and
- The property is covered for the entire term of the loan with flood insurance.

If the community in which the area is located does not participate in the NFIP, the financial institution is not restricted in making, increasing, extending or renewing a loan. Potential borrowers, however, must be notified that the community is not participating in the NFIP and that, in the event of a federally declared flood disaster, they would not be eligible for federal disaster relief funds.

Additional requirements are placed on financial institutions in connection with loans insured or guaranteed by an agency of the federal government, such as VA, FHA, and SBA. In this case, loans to construct or acquire real property or a manufactured home located in a SFHA may be made only if the community in which the property is located participates in the NFIP.

Personal property may require flood insurance if:

° Property is located in a flood hazard area as shown on a Flood Hazard Boundary Map or a Flood Insurance Rate Map; and

° the personal property secures a conventional loan that is also secured by real property or a manufactured home required to be covered by flood insurance; or

° the loan for the property is insured or guaranteed by an agency of the federal government.

If the loans for personal property does not involve federal financial assistance, flood insurance is not required.

Flood insurance requirements with respect to a particular community are altered by the issuance or withdrawal of FEMA's official flood maps. If the FEMA withdraws a Flood Hazard Boundary Map (for any reason), the insurance purchase requirement is completely suspended during the period of withdrawal. However, if the community is in the Regular Program and only the Flood Insurance Rate Map (which controls actuarial rates) is withdrawn, the financial institution should contact FEMA for a determination of flood insurance availability.

NOTICE REQUIREMENTS

When a loan is secured by improved real estate or a manufactured home located, or to be located, in a community that has been identified by the Director of FEMA as an area having special flood hazards, regardless of whether the community is participating or not participating in the NFIP, a financial institution must mail or deliver at least 10 days prior to the closing of a flood-related loan a written notice to the borrower which states:

- That the property securing the loan is or will be located in a flood hazard area (in lieu of such notification, a financial institution may obtain satisfactory written assurances from a seller or lessor that the borrower has been notified, prior to the execution of any agreement for sale or lease, that the property securing the loan is, or will be located, in a flood hazard area); and

- Whether or not federal disaster relief assistance will be available for such property in the event of damage to the property caused by flooding in a federally-declared disaster area (see sample notices). Community participation in the NFIP will determine if federal disaster relief assistance will be available and which notice the borrower will receive.

SAMPLE NOTICES*

(1) Notice to Borrower of Special Flood Hazards

Notice is hereby given to ____________ that the improved real estate or mobile home described in the attached instrument is, or will be, located in an area designated by the Director of the Federal Emergency Management Agency as an area having special flood hazards. This area is delineated on (name of community) Flood Insurance Rate Map ("FIRM") or, if the FIRM is unavailable, on the community's Flood Hazard Boundary Map ("FHBM"). (This area has at least a one per cent chance of being flooded within any given year. The risk of exceeding the one per cent chance increases with time periods longer than one year.) For example, during the life of a 30-year mortgage, a structure located in a special flood hazard area has at least 26 per cent chance of being flooded.

(2) Notice to Borrower about Federal Disaster Relief Assistance

(a) Notice to participating communities

The improved real estate or mobile home securing your

* These sample notices provide the required information. However, the indicated formats are not required.

loan is, or will be located, in a community that is now participating in the National Flood Insurance Program. In the event such property is damaged by flooding in a federally declared disaster, Federal disaster relief assistance may be available. However, such assistance will be unavailable if your community has been identified as a special flood hazard area for one year or longer and is not participating in the National Flood Insurance Program at the time the assistance would be approved. This assistance, usually in the form of a loan with a favorable interest rate, may be available for damages incurred in excess of your flood insurance.

(b) Notice in non-participating communities

The improved real estate or mobile home securing your loan is, or will be located, in a community that is not participating in the National Flood Insurance Program. This means that such property is not eligible for Federal flood insurance. In the event such property is damaged by flooding in a federally declared disaster, federal disaster relief assistance will be unavailable if your community has been identified as a special flood hazard area for one year or longer. Such assistance may be available only if at the time assistance would be approved your community is participating in the National Flood Insurance Program or has been identified as a special flood hazard area for less than one year.

WRITTEN ACKNOWLEDGEMENT

In addition, a financial institution must obtain from the borrower, prior to closing, a written acknowledgment that the property securing the loan is, or will be located, in a SFHA and that the borrower has received the mandatory notice regarding federal disaster relief assistance.

AMOUNT OF FLOOD INSURANCE

When flood insurance is required, the policy must cover the amount of the loan or the maximum amount available under the NFIP, whichever is less. When a community participates in the Emergency Program under NFIP, the amount of flood insurance available may not be sufficient to cover the amount of a flood-related loan since only first layer coverage is available under the Emergency Program. When community subsequently enters the Regular Program, the financial institution has no obligation to increase the amount of flood insurance required. However, it has the option to do so in order to protect its investment. In any event, the maximum insurance required by law for communities in the Regular Program is never more than twice the amount of coverage under the Emergency Program. Of course, the lender may require up to the amount of coverage available or the amount of the loan, whichever is less.

At the time of loan closing, a copy of the flood insurance application or the FEMA Proof of Purchase Certificate, indicating that the full premium has been paid, is sufficient evidence that application has been made for the purchase of flood insurance. If there is a transfer of title, the new owner applies for coverage at or before closing and the insurance goes into effect at 12:01 a.m. on the day following application and payment.

When no transfer of title occurs, the waiting period for flood insurance coverage is five days. Financial institutions may close a loan during that waiting period, knowing that the policy is not yet in effect. Lenders should, however, require the borrower to purchase coverage in a timely manner so that the policy becomes effective on or about the date of closing.

Flood insurance is written annually. Financial institutions are responsible for ensuring that the coverage is renewed and maintained for the duration of the loan. If the borrower does not renew the policy, the financial institution may renew it or call the loan (assuming the ability to call the loan is written into the contract). When designated as mortgagee, the financial institution generally receives a copy of the policy, as well as all renewal notices.

The loan closing and lien recording for construction loans may occur before any disbursement of funds. Flood insurance required for those loans need not exceed the amount of the financial institution's total disbursement to date. In those situations, proof of purchase is required only at the time funds are disbursed and not at the time of closing.

Limits of coverage under the Emergency Program and the Regular Program are listed in FEMA's latest publication concerning mandatory flood insurance purchase requirements. In general, the maximum amount of <u>required</u> flood insurance for covered property located in a community participating in the Emergency Program is also the maximum amount of <u>available</u> insurance. The maximum amount of <u>required</u> insurance for covered property located in a community participating in the Regular Program is only twice the coverage required by the Emergency Program, and is less than the maximum amount of <u>available</u> coverage.

RECORDKEEPING

Financial institutions must maintain sufficient records (e.g. copies of official maps, written contracts between the institution and the appraiser who has performed the flood check) to indicate the method used to determine whether improved real estate or a mobile home offered as security for a loan is located in a SFHA. Although not a requirement, financial institutions may also retain copies of the notices provided to the borrower, the borower's written acknowledgement of receipt, and if the purchase requirement applies, a copy of the flood insurance policy. Financial institutions should, but are not required to note that a flood hazard check has been performed on the property. Such a notation could be placed on the appraisal form or elsewhere in the loan application or loan docket file.

PENALTIES AND LIABILITIES

No specific civil or criminal penalties or liabilities are provided for in the FDPA. Administrative actions for violations may be pursued under the general regulatory powers of the respective supervisory agency. However, if the financial institution has not met all of the requirements of the FDPA and the borrower sustains a loss due to flooding, a financial institution may run the risk of being held liable in a negligence suit. Recent court decisions have stated that the FDPA does not grant a borrower a federal cause of action against a lender who violates the provisions of the FDPA or regulations issued by the regulatory agencies implementing the FDPA. However, these court decisions have not completely foreclosed borrowers from suing a depository institution on the basis of State statutes or common law. In fact, borrowers have successfully sued lenders in state courts.

FLOOD INSURANCE

EXAMINATION OBJECTIVES

1. To determine whether an institution has established an effective system for ascertaining whether property that secures a loan requires flood insurance.

2. To determine whether the institution provides the required flood insurance disclosures.

3. To determine whether the institution maintains sufficient records to evidence compliance with the flood insurance requirements of its supervisory agency.

EXAMINATION PROCEDURES

1. Determine whether any of the communities in the institution's trade area have designated SFHA, and whether or not any of the communities are participating in the NFIP.

2. Review the institution's policies, both written and informal, and internal controls concerning flood insurance, particularly, the method used by the institution to make the flood hazard determination. Interview the appropriate personnel to ascertain that these policies are implemented in the prescribed manner.

3. Obtain and review copies of the following:

   a. All records and other information, i.e., flood maps and appraisal forms, used to determine whether improved real estate or mobile homes are located in SFHA. 1/ Check these records to determine whether they are up-to-date. If the institution uses flood maps, verify that the institution has a flood map for each community in the trade area.

   b. Written notices (forms) that inform borrowers that the property securing a loan is in a SFHA and whether or not federal disaster relief assistance will be available if the property is damaged by flooding (refer to sample notices).

1/ In order to ascertain whether a community has been identified as flood prone and eligible for participation in the NFIP or to obtain the date of the current flood map, one may call the regional FEMA office.

c. Written acknowledgements from borrowers indicating their understanding that the property securing the loan is or will be located in a SFHA and that they have received the notice regarding the availability of federal disaster relief assistance.

4. Review an adequate sample of loan files to ascertain:

   a. that the institution's stated method of determining whether loans secured by improved real estate or a manufactured home are located in SFHA is followed in practice;

   b. that the institution requires flood insurance for covered loan related property located in a SFHA of a community that participates in the NFIP;

   c. that the institution does not make covered loans located in SFHA if the community does not participate in the NFP <u>and</u> the loan is insured or guaranteed by an agency of the federal government such as FHA, VA, SBA;

   d. that sufficient flood insurance coverage is provided when flood insurance is required; and

   e. that proper notifications are furnished to borrowers, as well as written acknowledgements are received from borrowers, within the required time limits.

   f. that lapsed policies are renewed where applicable.

5. Determine whether the institution has taken steps to correct violations regarding flood insurance which may have been cited in previous examinations.

FLOOD INSURANCE

EXAMINATION CHECKLIST

1. Does the institution offer or extend consumer or business loans (purchase or nonpurchase) 1/ that are secured by improved real property or manufactured homes as defined in the provisions of the National Flood Insurance Program, and if yes, does a review of loan records indicate that covered loans are offered or extended in communities with officially designated SFHA refer to official FEMA eligibility list)? Yes No

   If yes, complete the following sections.

Methods of Flood Hazard Determination

2. Does the review of records indicate the use of a satisfactory method of making flood hazard determinations? Yes No

3. Is a proper method used by branch and subsidiary offices? Yes No

4. If the institution makes the flood hazard determination (and does not have this function performed by an outside agent through a contract), are current flood maps maintained for all communities in the institution's trade area? Yes No

5. Does the institution ensure that flood insurance is obtained where appropriate? Yes No

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1/ The Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Comptroller of the Currency interpret the term financial assistance to include only the origination of mortgage loans and not the purchase of loans.

6. Indicate the method(s) used to make SFHA determinations.

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Consumer Notification Procedures

7. Does a review of forms and procedures indicate that proper written notices are provided in connection with covered loans? Yes No

8. If the institution does not provide such notification, does it obtain satisfactory written assurances from a seller or lessor that the borrower has been properly notified of the fact that the property is located in a SFHA prior to the execution of an agreement? Yes No

9. Are notifications provided within the required time limit? Yes No

10. Prior to closing, does the institution obtain a satisfactory written acknowledgement from the borrower that the improved property or manufactured home securing the loan is or will be located in a SFHA? Yes No

11. Indicate the method(s) of notification used.

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Sufficiency of Coverage

12. Does a review of files (or procedures) indicate that a sufficient amount of flood insurance coverage is required of loans granted within communities in:

   a. the Emergency Program? Yes No

   b. the Regular Program? Yes No

13. Does a review of files (or procedures) indicate that insurance policies are renewed annually? (Refer to workpapers from past examinations and list applicable customer names.) Yes No

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Nonparticipating Communities

14. If the institution grants federally related loans (such as FHA, VA, SBA loans) does it refrain from granting such loans when the property securing the loan is or will be located in a SFHA of a non-participating community? Yes No

15. Are proper notices of the unavailability of Federal disaster relief assistance (conventional loans only) given to borrowers whose property is located in a SFHA of a non-participating community? Yes No