

## SUMMARY OF FLOOD INSURANCE REQUIREMENTS

*Flood Hazard Determinations* (12 C.F.R. §§ 339.1, 339.6)

Flood hazard determinations must be performed before the closing of loans secured by buildings or mobile homes, including loans secured by commercial real estate. Lenders must document the determination using the Standard Flood Hazard Determination Form provided by the Federal Emergency Management Agency (FEMA) and retain that form for the life of the loan. The only exception to the rule requiring a determination before closing is when the permanent location of a mobile home will not be known until a later time. In that situation, the lender must ensure that the borrower informs the lender as soon as a permanent location for the mobile home is obtained, so that a flood hazard determination can be performed. If the mobile home is determined to be in a Special Flood Hazard Area (SFHA), then the borrower must be notified and the appropriate amount of flood insurance must be obtained.

It is important that the Standard Flood Hazard Determination Form be properly completed with all the required information. Note that the lender identification number (a common inquiry from banks) is the same as the FDIC certificate of insurance number for banks and savings associations, and is easily obtained from the FDIC's Web site at <http://www2.fdic.gov/idaspl/>. This number helps the National Flood Insurance Program (NFIP) track insurance policies in force.

*Fees and Charges* (12 C.F.R. § 339.8)

Lenders may charge borrowers a reasonable fee for determining whether the building or mobile home securing the loan is located or will be located in a SFHA. However, if your bank uses a third-party determination service, be careful that you do not charge the borrower more than the actual cost of the service. Volume discounts must be passed on to borrowers.

*Notices to Borrowers* (12 C.F.R. § 339.9)

NFIP notices must be provided to borrowers, using a form approved by FEMA<sup>1</sup>, within a reasonable time (generally ten days) before a bank makes, increases, extends or renews a loan secured by a building or mobile home located or to be located in a SFHA. The notices inform borrowers of the risks from floods, and measures they can take to mitigate those risks. The notices also inform borrowers whether flood insurance is available, and about the availability of federal disaster relief assistance in the event of flooding. A record that the borrower received the notice must be retained by the lender.

*Purchase Requirements* (12 C.F.R. § 339.3)

If improved real property securing a loan is located in a SFHA and flood insurance is available, then the lender must require the borrower to obtain the proper amount of flood insurance before closing the loan. The minimum required coverage is the lesser of the outstanding principal balance on the loan, or the maximum amount available from the NFIP. The amount of the insurance should not be less than the value of the improved structure.

Some lenders are reluctant to require borrowers to obtain flood insurance coverage for collateral property in SFHAs. This sometimes results from a reluctance to impose additional financial

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<sup>1</sup> A sample form of the notice is contained in Appendix A to 12 C.F.R. Part 339.

burdens on a borrower or a belief that the property is not really at risk of flooding. Neither of these is a valid reason for noncompliance with federal flood insurance requirements.

Aside from being required by law, flood insurance is a common sense risk-management tool for both lenders and borrowers. More than 75 percent of flood insurance claims are for buildings located inside SFHAs. The premiums are a small cost compared to the potential loss from a flood. Lenders can, at their discretion, require flood insurance even for property outside of SFHAs.

If you or the borrower have a reasonable basis to believe that an area has been improperly designated as a SFHA, then the borrower may apply to FEMA for a Letter of Map Amendment (LOMA). Unless a borrower obtains a LOMA, or a Letter of Map Revision (which must be initiated or approved by a community), lenders remain bound by current FEMA maps of SFHAs, and the requirement to purchase insurance coverage.

It is important to have a quality control review program to verify that borrowers obtain at least the minimum required coverage. The review should include checking insurance policies upon receipt from the insurance agent to confirm that the policies were written for the correct risk zone noted in the initial determination. Policies are sometimes issued for an incorrect zone, which results in borrowers not paying the correct premium. If the payment is insufficient for the actual risk, then a claim against the policy will not be honored until the lender or borrower pays the difference.

#### *Escrowing Flood Insurance Premiums (12 C.F.R. § 339.5)*

If a lender requires an escrow for taxes, insurance premiums, fees or other charges, then it must also escrow for required flood insurance premiums.

#### *Notice to FEMA (12 C.F.R. § 339.10)*

Lenders must notify FEMA of the identity of the loan servicer at the time a loan is made, increased, extended, renewed, sold or transferred, or if the loan servicer is changed during the life of the loan. The notice must be sent to the insurance carrier issuing the

flood insurance policy or the agent of record to endorse the flood policy to change the mortgagee or servicer. This helps ensure that the policy is maintained in force as long as insurance is required.

#### *Forced Placement of Flood Insurance (12 C.F.R. § 339.7)*

Lenders must force place insurance (purchase coverage on the borrower's behalf) in situations where a borrower either does not obtain required flood insurance coverage before closing a loan, or allows flood insurance coverage to lapse after the loan is made. The lender must purchase the insurance within 45 days of notifying the borrower that coverage is required. Federal flood insurance regulations permit no discretion in these situations. The borrower may be charged the premium or fee incurred.