Private Flood Insurance Rule Takes Effect July 1, Impacting Lenders and Borrowers

A final rule implementing provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 that require lenders to accept private flood insurance when issuing loans for real property within designated high-risk flood areas goes into effect July 1, 2019. The rule also addresses the conditions under which a lender may accept a noncompliant private policy or a plan offered by a mutual aid society as an alternative to traditional flood insurance. The final rule has three major components that lenders should note:

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• mandatory acceptance of private flood insurance

• discretionary acceptance of private flood insurance

• coverage by mutual aid societies.

Background
Federal law prohibits regulated lending institutions, including banks, credit unions and mortgage lenders, from making a loan secured by real property with improvements located within a qualifying special flood hazard area in a community that participates in the National Flood Insurance Program (NFIP) unless the property has sufficient flood insurance coverage for the full loan term.

To encourage the sale of private flood insurance, the Biggert-Waters Act was intended to rein in federal lending regulators and the practice of denying certain borrowers access to quality insurance coverage through the private flood insurance market. One of the important changes introduced by the Biggert-Waters Act requires lenders to accept a plan that meets the statutory definition of private flood insurance in lieu of a standard flood insurance policy (SFIP).

Since the Biggert-Waters Act was passed, Congress has instructed lending regulators to further encourage the expansion of the private flood insurance market. As a result, regulators issued a new proposed rule in 2016, which was finalized in February 2019 after two comment periods. The final rule streamlines financial standards requirements for insurance providers and alleviates compliance issues for lenders.

The approving regulatory agencies included the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and National Credit Union Administration.

Analysis
Mandatory Acceptance of Private Flood Insurance

Under the Biggert-Waters Act, institutions are required to accept private flood insurance that satisfies both the statutory definition of private flood insurance and the mandatory purchase requirement. Consistent with the Biggert-Waters Act, the final rule defines "private flood insurance" as an insurance policy that meets the following criteria:
• is issued by an insurer that is properly licensed, admitted or otherwise approved by the regulatory agency of that jurisdiction to provide insurance

• provides coverage at least as broad as an SFIP (accounting for deductibles, exclusions and other conditions imposed by the insurer)

• contains cancellation provisions at least as restrictive as an SFIP

• features a 45-day notice requirement before cancellation or nonrenewal

• presents information about the availability of flood insurance under the NFIP

• has a mortgage interest clause similar to that in an SFIP

• includes a provision that the insured must file a lawsuit within one year after a written claim denial.

A lender must accept any policy meeting all the private flood insurance conditions.

The final rule contains a “compliance aid” provision meant to assist lenders in evaluating and accepting policies. Lenders may rely on written assurances from the insurer that a given policy meets the requirements of the Biggert-Waters Act. Written assurances should be included in, or as an endorsement to, the policy and should include 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.”

While the final rule does not require insurance companies to include this statement, lenders cannot reject a private policy solely because it does not contain this statement. The lender is not bound by this statement and may conduct its own due diligence when reviewing a policy.

*Discretionary Acceptance of Private Flood Insurance*

The final rule provides that lenders may accept private flood insurance policies that do not meet the statutory and regulatory definition of private flood insurance, provided that the policy satisfies a limited set of criteria. The criteria include the following:
• The policy must provide coverage equal to the coverage provided by an SFIP.

• The policy must be issued by an insurer that is properly licensed, admitted or otherwise approved by the regulatory agency of that jurisdiction to provide insurance.

• The policy must cover both the lender and borrower as loss payees (except when an insurance payment is provided by a condominium or homeowners association or similar group).

• The policy must provide sufficient protection of the designated loan consistent with general safety and soundness principles, and the lender must document in writing its determination that the loan is sufficiently protected.

Coverage by Mutual Aid Societies

• The final rule provides that lenders may accept flood plans issued by mutual aid societies as long as certain conditions are met. The conditions include the following:

• The policy must provide coverage equal to the coverage provided by an SFIP.

• The policy must cover both the lender and borrower as loss payees.

• The policy must provide sufficient protection of the designated loan consistent with general safety and soundness principles, and the lender must document in writing its determination that the loan is sufficiently protected.

• The lender’s primary federal regulator must approve the plan.

The final rule defines “mutual aid society” as an organization (1) whose members share a common religious, charitable, educational or fraternal bond, (2) that covers losses caused by damage to members’ property, including damage caused by flooding, pursuant to an agreement in accordance with this common bond, and (3) that has a demonstrated history of fulfilling the terms of agreements to cover losses to members’ property caused by flooding.
Takeaways

Lenders’ practices will be impacted by the issuance of the final rule. As of July 1, 2019, compliance is mandatory, and lenders can no longer accept only NFIP insurance. Instead, borrowers can satisfy insurance requirements through a range of private and public flood insurance options.

Lenders must review their loan approval and servicing procedures immediately to ensure they comply with the final rule’s July 1 effective date. Borrowers should evaluate any private flood insurance options to determine if they are a cost-effective substitute for traditional flood insurance. The rule tries to be accommodating, but still places burden and risk on the lenders so they will have to weigh the competitive benefits against the costs and risks of accepting alternative insurance.

Lenders may experience increased scrutiny from auditors in the discretionary determination that a plan satisfies the required criteria. Compliance staff has the burden of ensuring private policies (including nonconforming policies) and nontraditional flood coverage issued by mutual aid societies provide sufficient protection to their organization, while also adhering to the conditions set forth in the rule. This is especially true for small and medium-sized lenders with limited compliance staff. If implemented correctly, the compliance aid language would alleviate some of the burden on compliance staff and help streamline the process of evaluating and accepting policies.