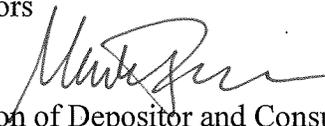


October 3, 2016

MEMORANDUM TO: Board of Directors

FROM: Mark Pearce 
Director, Division of Depositor and Consumer Protection

SUBJECT: NPRM to Implement Requirements of the Biggert-Waters Flood Insurance Reform Act of 2012

SUMMARY OF RECOMMENDATION

Staff recommends that the FDIC's Board of Directors approve the attached Notice of Proposed Rulemaking (NPRM), entitled *Loans in Areas Having Special Flood Hazards – Private Flood Insurance*, for publication in the *Federal Register* for a sixty-day comment period. The NPRM would implement certain provisions set forth in the Biggert-Waters Flood Insurance Reform Act of 2012 (B-W Act)¹ regarding private flood insurance. Specifically, the proposed rule would require lenders to accept policies that meet the statutory definition of private flood insurance in the B-W Act and permit such institutions to accept private flood insurance policies that do not meet the statutory definition of “private flood insurance” on a discretionary basis, subject to restrictions. The regulation would amend Part 339 of Title 12 of the Code of Federal Regulations. If approved, the NPRM would be issued jointly by the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit Union Administration, and the Farm Credit Administration (collectively, the “Agencies”).

CONCUR:


Charles Yi
General Counsel
Legal Division

¹ Pub. L. 112-141, 126 Stat. 916 (2012).

Background

Federal flood insurance legislation makes subsidized flood insurance available to owners of improved real estate or mobile homes located in participating communities and requires the purchase of flood insurance in connection with a loan when secured by improved real estate or a mobile home located in a special flood hazard area (SFHA) in which insurance is available under the National Flood Insurance Program (NFIP). The B-W Act amended Federal flood insurance legislation to: (1) require the Agencies to issue a rule regarding the escrow of premiums and fees for flood insurance; (2) clarify the requirement to force place insurance; and (3) require the Agencies to issue a rule to direct lenders to accept “private flood insurance,” as defined by the B-W Act, and to notify borrowers of the availability of private flood insurance.

On October 30, 2013, the Agencies jointly issued proposed rules to implement the escrow, force-placement, and private flood insurance provisions of the B-W Act (2013 NPRM).² The 2013 NPRM would have required a lender to accept all coverage meeting the statutory definition of “private flood insurance.” The Agencies sought comment on a safe harbor that would have allowed lenders to rely on State insurance regulators to determine whether a policy meets the definition of private flood insurance. If such a determination was made, acceptance by a lender would have been required. Additionally, the Agencies asked whether the rule should expressly permit lenders to accept, at their discretion, a private flood insurance policy that does not meet the B-W Act definition of private flood insurance (discretionary acceptance). The Agencies also solicited comment on what criteria might be required for such a policy.

The Agencies received 81 written comments on the 2013 NPRM, including 51 comments addressing some aspect of private flood insurance. These commenters addressed specific issues, such as the regulatory definition of “private flood insurance;” the use of a regulatory safe harbor to facilitate compliance by lenders; whether private flood insurance that does not conform to the statutory definition of the term should be accepted by lenders; whether alternative criteria for such non-conforming private flood insurance should be developed; and whether lenders should be permitted to accept certain non-traditional, non-conforming flood insurance coverage by “mutual aid societies” such as Amish Aid plans.

On March 21, 2014, the Homeowner Flood Insurance Affordability Act (HFIAA)³ was enacted, which, among other things, amended the B-W Act requirements regarding escrow of flood insurance premiums and fees and created a new exemption from the mandatory flood insurance purchase requirements for certain detached structures. Accordingly, the Agencies jointly issued a new proposed rule on October 30, 2014, to implement the HFIAA amendments.⁴ On July 21, 2015, the Agencies jointly issued final rules to implement HFIAA amendments and B-W Act force-placed flood insurance provisions.⁵ In this rulemaking, the Agencies announced that they planned to address the private flood insurance provisions in a separate rulemaking. This NPRM would satisfy this commitment.

² 78 FR 65108.

³ Pub. L. 113-89, 128 Stat. 1020 (2014).

⁴ 79 FR 64518.

⁵ 80 FR 43216.

Summary of the NPRM

Definitions

Mutual aid society: In connection with the proposal to accept flood policies issued by mutual aid societies (discussed below), the Agencies propose to add a definition of “mutual aid society.” To qualify as a mutual aid society: (1) the members must share a common religious, charitable, educational, or fraternal bond; (2) the organization must cover losses including those from flooding to members’ property pursuant to an agreement, in accordance with this common bond; and (3) the organization must have a demonstrated history of covering losses to members’ property caused by flooding.

Private flood insurance: The NPRM would include the B-W Act definition of private flood insurance: (1) issued by an insurance company that may legally do business in a state or jurisdiction; (2) provides coverage at least as broad as that provided under a FEMA standard flood insurance policy (SFIP); (3) requires an insurer to give written notice 45 days before cancellation or non-renewal of flood insurance coverage to the insured and the lender; (4) includes information about NFIP insurance availability; (5) includes a mortgage interest clause similar to that in an SFIP; (6) requires an insured to file suit no later than one year after a claim is denied; and (7) has cancellation provisions as restrictive as those in an SFIP.

At least as broad as: Many commenters on the 2013 NPRM asserted it would be difficult for institutions to determine whether private flood insurance coverage is “at least as broad as” SFIP coverage. In response, the Agencies have proposed to clarify that a policy is “at least as broad as” SFIP coverage if the policy, at a minimum: (1) defines “flood” to include SFIP-defined “flood” events; (2) covers borrower and lender as loss payees; (3) contains SFIP coverage provisions, including those relating to real property, personal property, other coverages, and the increased cost of compliance; (4) contains deductibles no higher than the specified NFIP maximum for the same type of property; (5) provides coverage for direct physical loss caused by a flood; and (6) does not narrow the coverage provided in an SFIP. The Agencies have specifically requested comment on whether these criteria facilitate a lender’s determination of whether flood insurance coverage is “at least as broad as” SFIP coverage.

Flood Insurance Purchase Requirement

As in the 2013 NPRM, the Agencies propose to implement the B-W Act amendment that requires that all lenders accept “private flood insurance” as defined by statute, if certain conditions are met. Specifically, the NPRM includes a new provision that would require a lender to accept a private flood insurance policy that meets both: (1) the statutory definition of “private flood insurance” and (2) the mandatory purchase requirement.

Compliance Aid for Mandatory Acceptance

The 2013 NPRM proposed to add a safe harbor that would have allowed lenders to rely on a State insurance regulator's written determination that a particular private insurance policy satisfies the definition of "private flood insurance" and, therefore, must be accepted by the lender in satisfaction of the mandatory purchase requirement. The safe harbor was proposed to address concerns raised that lenders would have difficulty evaluating whether a flood insurance policy meets the definition of private flood insurance, due to a lack of technical expertise.

Some commenters expressed support for a safe harbor, with several noting that few lenders have the capacity to determine whether policies meet the required standards. Other commenters criticized the proposed safe harbor, however, and suggested alternatives. Among those suggested, some commenters recommended that, instead of a State insurance regulator, the insurance company should certify that the private flood insurance policy meets the statutory definition. One commenter stated that the insurance company should not only certify compliance with Federal law, but also indemnify the lender if the policy should prove noncompliant and result in a loss to the lender. Another commenter recommended that an insurer's certification should state that the private flood insurance policy's coverage is "at least as broad as" that provided under the NFIP.

In response, the Agencies have proposed a compliance aid provision to assist consumers and lenders in determining whether a policy meets the definition of "private flood insurance" and therefore must be accepted as long as it otherwise meets the mandatory purchase requirement. The proposed compliance aid provision would deem a policy to meet the definition of "private flood insurance" if the policy has a written summary that demonstrates how the insurer and the policy complies with the definition of private flood insurance; the lender verifies in writing that the policy includes the provisions identified by the insurer in its summary as complying with the definition of private flood insurance and that these provisions satisfy the stated criteria; and the policy affirmatively states that it meets the B-W Act definition of private flood insurance. This would not relieve a lender of the requirement to accept a policy that meets the private flood insurance definition and the mandatory purchase requirement, even if the policy has no written summary and does not declare that it meets the definition.

Discretionary Acceptance

In the 2013 NPRM, the Agencies specifically requested comment as to whether a lender should be allowed to accept a flood insurance policy issued by a private insurer that does not meet the statutory definition, but otherwise would provide coverage consistent with Federal flood insurance legislation. A majority of commenters supported this proposal. The proposal would provide greater flexibility to accept private flood insurance policies on a discretionary basis.

In addition to soliciting comment on whether the rule should specifically state that lenders may accept private flood insurance policies on a discretionary basis, the Agencies asked whether criteria should be required for such policies. The Agencies received comments on the imposition of such criteria. Among the alternatives suggested, some commenters recommended that the insurance company should certify that the private flood insurance policy being provided meets

the statutory definition. Commenters also suggested that the Agencies provide model certification language or a certification checklist. This NPRM adds criteria intended to address some of the comments received.

In response to public comments, the Agencies propose allowing a lender to exercise discretion to accept certain types of flood insurance policies issued by a private insurer that do not satisfy the statutory definition of the term. Specifically, the NPRM would expressly permit a lender to accept other types of flood insurance policies, provided the following criteria are met. The policy must be issued by an authorized insurer; cover both lender and borrower as loss payees; provide for cancellation only for the same reasons permitted under an SFIP; and either be “at least as broad as” SFIP coverage or provide “similar” coverage. In determining whether coverage is similar to SFIP coverage, the NPRM would require a lender to: (1) compare the private policy with an SFIP to determine any differences; (2) reasonably determine the private policy provides sufficient protection of the loan secured by the property in a SFHA; and (3) document its findings.

Exception for Mutual Aid Societies

The proposed rule also includes an exception for certain private flood coverage provided by mutual aid societies. This proposed exception responds to 2013 NPRM comments that supported permitting lenders to accept certain nontraditional coverage that does not satisfy the statutory definition for “private flood insurance” such as Amish Aid plans, even though this coverage is not provided by a State-regulated insurance company. Under this proposed exception, flood protection offered by mutual aid societies that would not meet all of the previously discussed requirements for discretionary acceptance could continue to be offered, for example, to members of religious communities who do not purchase insurance from traditional insurance companies, provided certain conditions are met.

Specifically, the proposed rule would permit a lender to accept coverage provided by a mutual aid society in satisfaction of the mandatory flood insurance purchase requirement if the policy meets the amount of coverage for losses and term requirements in the mandatory flood insurance purchase requirement; the policy covers both borrower and lender as loss payees; the lender has determined that the policy provides sufficient protection of the loan secured by the property located in a SFHA; and the institution’s primary supervisory agency determines that such policy or types of policies meet the requirement for flood insurance for purposes of Federal flood insurance legislation.

In determining whether a policy issued by a mutual aid society provides sufficient protection under the proposed rule, a lender would have to verify that the policy is consistent with general safety and soundness principles, such as whether deductibles are reasonable based on the borrower’s financial condition; consider the provider’s ability to satisfy claims, such as whether it has a demonstrated record of covering losses; and document its conclusions. Under the proposed rule, it would be left to each Agency’s discretion to determine whether policies offered by mutual aid societies qualify as acceptable flood insurance.

Discretionary Acceptance for Nonresidential Property

The mandatory flood insurance purchase requirement applies to both residential and nonresidential properties. Flood insurance policies issued by private insurers covering nonresidential loans secured by commercial properties may have coverage, deductibles, exclusions, and conditions that differ from NFIP policies based on the type, size, and number of nonresidential properties covered by the policy. In some instances, such policies are individually negotiated and tailored to the nonresidential property that secures a loan. The NPRM would request comment on whether the proposed definition of “private flood insurance” or the proposed discretionary acceptance provision would prevent lenders from accepting flood insurance policies issued by private insurers in the nonresidential lending context. The NPRM also requests specific comment on whether the final rule should include criteria for the discretionary acceptance of flood insurance policies issued by private insurers for nonresidential properties that are different from the criteria applicable to flood insurance policies issued by private insurers for residential properties.

Recommendation

Staff recommends the Board approve the attached Resolution to adopt and authorize the publication in the *Federal Register* of the attached NPRM for a sixty-day comment period.

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Attachments