



Federal Deposit Insurance Corporation  
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Financial Institution Letter  
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## LAPSE OF FEMA AUTHORITY TO ISSUE FLOOD INSURANCE POLICIES

**Summary:** The authority of the Federal Emergency Management Agency (FEMA) to issue flood insurance policies under the National Flood Insurance Program (NFIP) lapsed between March 28 and April 16, 2010. The attached guidance provides information for institutions about their continuing responsibilities during such lapse periods.

### Distribution:

FDIC-Supervised Banks (Commercial and Savings)

### Suggested Routing:

Chief Executive Officers  
Chief Lending Officers  
Compliance Officers

### Attachment:

Lapse of FEMA Authority to Issue Flood Insurance Contracts

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### Note:

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Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (1-877-275-3342 or 703-562-2200).

### Highlights:

- State non-member banks may continue to make loans subject to the National Flood Insurance Act, as amended, 42 U.S.C. §§ 4001-4029, and 12 C.F.R. Part 339, without flood insurance during a period when the NFIP is not available. Such lending does not violate Part 339.
- Despite a lapse of FEMA authority, banks must continue to:
  - make flood determinations,
  - provide timely, complete and accurate notices to borrowers, and
  - comply with other parts of the flood insurance regulations.
- Banks should evaluate safety-and-soundness and legal risks during the lapse period and prudently manage those risks. Appropriate measures should be taken to mitigate loss exposures.
- Regulated institutions should have a system in place to ensure flood insurance policies are obtained as soon as available following reauthorization for properties subject to the mandatory purchase requirement.
- Current FEMA guidance to the companies and agents who handle NFIP policies is available at the following Website:  
<http://www.nfipiservice.com/stakeholder/pdf/bulletin/W-10036.pdf>



## LAPSE OF FEMA AUTHORITY TO ISSUE FLOOD INSURANCE CONTRACTS

This guidance assists lenders in meeting their compliance obligations under the National Flood Insurance Program (NFIP) during periods when the statutory authority of the Federal Emergency Management Agency (FEMA) to issue flood insurance contracts under the NFIP lapses. The required NFIP authorization by Congress lapsed on March 1 and 2, 2010, but was temporarily reauthorized through March 28, 2010. The NFIP again lapsed between March 28 and April 16, 2010, and was reauthorized through May 31, 2010. This guidance applies to the March and April lapse periods and will continue to apply if there are future lapses in the NFIP.

**Background:** The National Flood Insurance Act and the Flood Disaster Protection Act of 1973, as amended (the Flood Act), prohibit lenders from making, increasing, extending or renewing loans secured by improved real property or a mobile home located in a special flood hazard area (SFHA) 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, FEMA cannot issue new or renewal flood insurance policies or increase coverage on existing policies. Borrowers cannot obtain NFIP insurance to close, renew or increase loans secured by property located in an SFHA until the NFIP is reauthorized, except under the circumstances described below. This letter contains informal guidance for lenders and borrowers on issues that may arise during a period of lapsed authorization concerning loans that are or will be secured by property located in an SFHA.

**Summary:** During a period when the NFIP is not available, financial institutions supervised by the FDIC may make loans subject to the Flood Act and 12 C.F.R. Part 339 without flood insurance coverage. Such lending does not violate Part 339. 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, institutions should evaluate safety-and-soundness and legal risks and prudently manage those risks during the lapse period. Appropriate measures should be taken to mitigate loss exposures. Further, institutions should have a system in place to ensure flood insurance policies are obtained as soon as available upon reauthorization of the NFIP for properties subject to mandatory flood insurance coverage.

The following questions and answers provide additional details on these topics.

### **Ability to Make Loans Unaffected by Lack of Authority**

- *Does a lapse in FEMA flood insurance authority mean loans secured by improved real property located in SFHAs may not be made by lenders?*

No, it does not. Flood insurance is not available under the NFIP during a lapse in authority, but lenders are not precluded from making loans due to the lack of coverage. During a lapse, a lender may make a loan secured by improved real property in an SFHA without requiring the borrower to obtain flood insurance coverage. However, this does not mean a lender is relieved of other obligations under federal flood insurance law nor does it mean that safety-and-soundness considerations can be disregarded. Both of these matters are addressed in more detail below.

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

- *Do regulated institutions 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 also must give borrowers the notice of special flood hazards and availability of federal disaster relief, if applicable, as required by 12 C.F.R. Part 339.

### **Retroactivity of Reauthorized Flood Insurance Policies**

- *Why does retroactivity matter?*

If NFIP 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 before the date of Congressional reauthorization. Lenders are encouraged to ensure borrowers understand this risk.

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 received before an expiration of FEMA's authority to issue flood insurance?*

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 before 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, and for policies that would otherwise have expired during the lapse period.

### **Flood Insurance Coverage During the Lapse**

- *What are my options regarding new loans that will be affected by a lapse?*
- You can have a borrower complete the application and pay the premium, which will be held by the insurance company for processing pending congressional reauthorization. In addition:
  - These applications will be processed as soon as the program is reauthorized and 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. You should also advise them of the consequences of non-retroactive reauthorization.
  - You should ensure 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 the risk of loss is sufficient to justify a postponement in closing the loan until the NFIP has been reauthorized.
- You may require the borrower to obtain private flood insurance where available, as a condition of closing the loan. 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, the FDIC expects that flood insurance will be obtained for these loans, including, if necessary, by forced placement, as provided for in 12 C.F.R. § 339.7. Before making such loans, you should ensure borrowers are aware of the flood insurance requirements and that force-placed insurance is typically more costly than borrower-obtained insurance. You also should have a system to identify these loans to ensure that insurance is purchased if the NFIP is reauthorized 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 SFHAs, 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?*

For applications and premiums received on or after a lapse begins, FEMA generally processes all renewals as soon as the program is reauthorized. Lenders are encouraged to notify their servicers that flood insurance payment premiums may continue to be accepted during the lapse. Lenders who act as their own servicers may also continue to accept 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.

Bank management should be aware of the level of overall portfolio risk created by the lapse in insurance coverage, particularly when a significant portion of lending activity takes place in a SFHA.

### **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 purchasers. 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 the FHA, VA or other federal guarantee agency, as appropriate.

### **Agency Flood Insurance Enforcement**

- *Will my financial institution violate Part 339 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 located or to be located in an SFHA 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.

However, you must still make flood determinations, provide timely, complete and accurate notices to borrowers, and comply with other 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 before 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 339.