PRIVATE FLOOD INSURANCE

I. INTRODUCTION

The federal banking agencies have published a Final Rule on private flood insurance. The Final Rule implements the private flood insurance requirements originally enacted in the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters). The Final Rule:

1. Implements the Biggert-Waters requirement that institutions accept private flood insurance policies meeting specific criteria;
2. Defines “private flood insurance” for purposes of determining whether acceptance is required;
3. Allows institutions to rely on an insurer's written assurance (“compliance aid”) in the private policy that the specific criteria have been met;
4. Clarifies that institutions may accept private policies that do not meet the specific criteria, under certain circumstances; and
5. Permits institutions to accept flood insurance plans provided by mutual aid societies in certain cases.

The Final Rule is effective on July 1, 2019.

II. PRIVATE FLOOD INSURANCE

A private flood insurance policy must:

1. Be issued by an insurer or surplus lines insurer licensed by the insurance regulator in the state where the property is located;
2. Provide flood insurance coverage that is “at least as broad” as that under a National Flood Insurance Program (NFIP) Standard Flood Insurance Policy (SFIP), specifically considering deductibles, exclusions, and conditions;
3. Include a requirement for the insurer to give 45–day written notice before cancellation or non–renewal;
4. Include information about the availability of flood insurance coverage under the NFIP;
5. Include a mortgage interest clause similar to the clause in an SFIP;
6. Include a one–year statute of limitations provisions; and
7. Contain cancellation provisions that are as restrictive as the provisions in an SFIP.

Under the Final Rule, a policy is “at least as broad as” the coverage provided under an SFIP if the following conditions are met:
1. Defines “flood” to include the same events defined as a “flood" in an SFIP;
2. Has the same types of coverage and provisions available in an SFIP, including:
   - building property coverage;
   - personal property coverage;
   - other coverages; and
   - the increase cost of compliance.
3. Has deductibles that are no higher than the NFIP maximum for the same type of property, and includes non–applicability provisions that are similar to those in an SFIP;
4. Provides coverage for direct physical loss caused by a flood and may exclude other types of loss that are included in an SFIP; and
5. Does not contain any other conditions that provide less coverage than would be provided in an SFIP.

III. MANDATORY ACCEPTANCE AND COMPLIANCE AID

The Final Rule requires institutions to accept any “private flood insurance" that meets the definition set forth above. Under the Final Rule, an institution can determine that a policy meets the definition of private flood insurance as long as the policy or an endorsement contains the following sentence: “This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012 a(b)(7) and the corresponding regulation." An institution may not refuse a policy simply because it does not contain the foregoing statement. In such a case, the institution must make its own determination regarding whether the policy meets the definition of “private flood insurance” set forth above.

IV. DISCRETIONARY ACCEPTANCE

The Final Rule maintains the option for institutions to accept certain flood insurance policies issued by private insurers, even if the policy doesn’t meet the definition of “private flood insurance.” The Final Rule contains the following requirements for discretionary acceptance:

1. The policy meets the minimum coverage requirements (equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act);
2. The policy is issued by an insurer that is licensed, admitted, or otherwise approved to do business where the property is located; or for non–residential commercial property, is issued by surplus lines insurer recognized or not disapproved where the property is located;
3. The policy covers both the mortgagor and mortgagee as loss payee; and
4. The policy provides sufficient protection for a designated loan, consistent with general safety and soundness principles and the institution documents its conclusion regarding sufficiency of the protection of the loan in writing.

While the Final Rule does not outline documentation expectations, the Agencies note in the Preamble to the Final Rule that lending institutions may consider several factors to determine whether a policy provides sufficient protection. These include:
1. Whether the flood insurance policies deductibles are reasonable based on the borrower’s financial condition;
2. Whether the insurer provides adequate notice of cancellation to the mortgagor and mortgagee to ensure timely force placement of flood insurance, if necessary;
3. Whether the terms and conditions of the flood insurance policy with respect to payment per occurrence or per loss and aggregate limits are adequate to protect the regulated lending institution’s interest in the collateral;
4. Whether the flood insurance policy complies with applicable State insurance laws; and
5. Whether the private insurance company has the financial solvency, strength, and ability to satisfy claims.

V  MUTUAL AID SOCIETY

The Final Rule allows institutions to choose whether to accept certain plans providing flood coverage issued by “mutual aid societies.” A “mutual aid society” is defined as an organization that meets the following three criteria:

1. The members must share a common religious, charitable, educational, or fraternal bond;
2. The organization must cover losses caused by damage to members’ property pursuant to an agreement, including damage caused by flooding, in accordance with this common bond; and
3. The organization must have a demonstrated history of fulfilling the terms of the agreements to cover losses to members' property caused by flooding.

An institution may accept a plan issued by a mutual aid society if:

1. The institution’s regulator has determined that the plan qualifies as flood insurance for purposes of the Act;
2. The plan meets the minimum coverage requirements;
3. The plan covers both the mortgagor(s) and the mortgagee(s) as loss payees; and
4. The plan provides sufficient protection for a designated loan, consistent with general safety and soundness principles, and the institution documents this in writing.

Institutions are not required to accept a plan from a mutual aid society, assuming the plan does not otherwise meet the definition of private flood insurance.

The foregoing Compliance Update is for informational purposes only and does not constitute legal advice. As a reminder, the NBA general counsel is the attorney for the Nebraska Bankers Association, not its member banks. The general counsel is available to assist members with finding resources to help answer their questions. However, for specific legal advice about specific situations, members must consult and retain their own attorney.