

Module: Compliance

Section: Flood Insurance

EM-650

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Authority and Purpose

The National Flood Insurance Program (NFIP) is administered primarily under two statutes: the National Flood Insurance Act of 1968 (1968 Act) and the Flood Disaster Protection Act of 1973 (FDPA).¹ The 1968 Act made Federally subsidized flood insurance available to owners of improved real estate or mobile homes located in special flood hazard areas (SFHA) if their community participates in the NFIP. The NFIP is administered by the Federal Insurance Administration (FIA), a department of the Federal Emergency Management Agency (FEMA). The FDPA requires Federal financial regulatory agencies to adopt regulations prohibiting their regulated lending institutions from making, increasing, extending or renewing a loan secured by improved real estate or a mobile home located or to be located in an SFHA in a community participating in the NFIP unless the property securing the loan is covered by flood insurance.

Title V of the Riegle Community Development and Regulatory Improvement Act of 1994² which is called the National Flood Insurance Reform Act of 1994 (Reform Act), comprehensively revised the Federal flood insurance statutes. The purpose of the Reform Act is to increase compliance with flood insurance requirements and participation in the NFIP in order to provide additional income to the National Flood Insurance Fund and to decrease the financial burden on the Federal government, taxpayers, and flood victims.³ The Reform Act required the Federal financial regulatory agencies⁴ to revise their current flood insurance regulations and brought the Farm Credit Administration (FCA) under coverage of the Act. These agencies issued a joint final rule (final rule) on August 29, 1996, (61 FR 45684).

The Reform Act also applied flood insurance requirements directly to the loans purchased by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and to agencies that provide government insurance or guarantees such as the Small Business Administration, Federal Housing Administration and the Veteran's Administration. However, Congress did not make Farmer Mac subject to flood insurance requirements.

Objectives of the FDPA:

- Provide flood insurance to owners of improved real estate located in SFHAs of communities participating in the NFIP;
- Require communities to enact measures designed to reduce or avoid future flood losses as a condition for making Federally subsidized flood insurance available;
- Require Federal financial regulatory agencies to adopt regulations prohibiting their regulated lending institutions from making, increasing, extending or renewing a loan secured by improved real estate or a mobile home located or to be located in an SFHA of a community participating in the NFIP, unless the property securing the loan is covered by flood insurance.

¹ These statutes are codified at 42 U.S.C. 4001-4129. FEMA administers the NFIP; its regulations implementing the NFIP appear at 44 CFR parts 59-77.

² Pub. L. 103-325, tit. V, 108 Stat. 2160, 2255-87 (September 23, 1994).

³ H.R. Conf. Rep. No. 652, 103d Cong., 2d Sess. 195 (1994) (Conference Report).

⁴ The agencies are the OCC, FDIC, OTS, NCUA and Federal Reserve.

- Prohibit Federal agencies, such as the Federal Housing Administration (FHA), Small Business Administration (SBA) and the Department of Veterans' Affairs (VA) from subsidizing, insuring, or guaranteeing any loan if the property securing the loan is in an SFHA of a community not participating in the NFIP.

Responsibilities of FIA:

- Identify communities with SFHAs.
- Issue flood boundary and flood rate maps for flood-prone areas.
- Make flood insurance available through the NFIP "Write Your Own" Program (WYO) which enables the public to purchase NFIP coverage from private companies that have entered into agreements with FIA.
- Assist communities in adopting flood plain management requirements.
- Administer the insurance program. Licensed property and casualty insurance agents and brokers provide the primary connection between the NFIP and the insured party. Licensed agents sell flood insurance, complete the insured party's application form, report claims and follow-up with the insured for renewals of the policies.

National Flood Insurance Program

The NFIP has two distinct phases, the Emergency Program and the Regular Program.

The Emergency Program is for communities that first enter the NFIP. It is an interim program that provides lower levels of flood insurance on eligible structures at subsidized rates. FEMA issues flood hazard boundary maps with this program to determine whether properties are located in a flood plain area. A community that is in the Emergency Program will be admitted to the Regular Program upon completion of specific requirements.

A community enters the Regular Program once a detailed study has been completed and a flood insurance rate map for the area has been issued by FEMA. Flood insurance rate maps delineate communities by degrees of probable flood hazard and include more specific area identification than do the flood hazard boundary maps. They also indicate base flood elevations depicting depth or elevation of flooding. The Regular Program provides full insurance coverage for eligible structures and it includes additional flood-plain management responsibilities for the communities.

Applicability and Exemptions

Eligible Structures for Flood Insurance

The NFIP covers improved real property or mobile homes located or to be located in an area identified by FEMA as having special flood hazards. Generally each insurable structure requires a separate insurance policy, although FEMA does provide special consideration for some nonresidential buildings. The following types of structures are eligible for coverage:

- Residential, industrial, commercial, and agricultural buildings that are walled and roofed structures that are principally above ground.
- Buildings under construction where a development loan is made to construct insurable

improvements on the land. Insurance can be purchased to keep pace with the new construction.

- Mobile homes that are affixed to a permanent site, including mobile homes that are part of a dealer's inventory and affixed to permanent foundations.
- Condominiums.
- Co-operative buildings.
- Flood insurance coverage is also available for personal property and other insurable contents contained in real property or mobile homes located in SFHAs. The property must be insured in order for the contents to be eligible.

Structures not eligible for flood insurance under the NFIP

- Unimproved land, bridges, dams and roads.
- Mobile homes not affixed to a permanent site.
- Travel trailers and campers.
- Converted buses or vans.
- Buildings entirely in, on, or over water into which boats are floated.
- Buildings newly constructed or substantially improved on or after October 1, 1983, in an area designated as an undeveloped coastal barrier with the Coastal Barrier Resource System established by the Coastal Barrier Resources Act (Public Law 97-348).

Flood Insurance Requirements for Lending Institutions

Basic Requirement § 614.4930

Flood insurance is required for the term of the loan on buildings or mobile homes when all three of the following factors are present:

- The institution makes, increases, extends, or renews any loan(s) (commercial or consumer) secured by improved real estate or a mobile home that is affixed to a permanent foundation ("security property");
- The property securing the loan is located or will be located in an SFHA as identified by FEMA; and
- The community participates in the NFIP.

In the case of mobile homes, the criterion for coverage turns on whether the mobile home is affixed to a permanent foundation. An institution does not have to obtain a security interest in the underlying real estate in order for the loan to be covered by the final rule.

Institutions are not prohibited from making, increasing, extending, or renewing a *conventional* loan if the community in which the security property is located has been mapped by FEMA but does not participate in the NFIP. However, Federal flood insurance is not available in these communities. In addition, it should be noted that government guaranteed or insured loans (secured or unsecured) cannot be made if the community has been mapped by FEMA but does not participate in the NFIP.

Flood insurance requirements apply to loans where a security interest in improved real property is only taken in "an abundance of caution." Section 102(b)(1) of the FDPA, as amended by the Reform Act,⁵ provides that a regulated lending institution may not make, increase, extend, or renew any loan secured by improved real property that is located in a special flood hazard area unless the improved real property is covered by the minimum amount of flood insurance required by statute.

Special Situation-- Table Funded Loans

In the typical table-funding situation, the party providing the funding reviews and approves the credit standing of the borrower and issues a commitment to the broker or dealer to purchase the loan at the time the loan is originated. Frequently, all loan documentation and other statutorily mandated notices are supplied by the party providing the funding, rather than the broker or dealer. The funding party provides the original funding "at the table" when the broker or dealer and the borrower close the loan. Concurrent with the loan closing, the funding party acquires the loan from the broker or dealer. While the transaction is, in substance, a loan made by the funding party, it is structured as the purchase of a loan.

The final rule reflects the position that, for flood hazard determination purposes, the substance of the table-funded transaction should control and the typical table funded transaction should be considered a loan made, rather than purchased, by the entity that actually supplies the funds. Regulated institutions that provide table funding to close loans originated by a mortgage broker or mobile home dealer will be considered to be "making" a loan for purposes of the flood insurance requirements.

Treating table funded loans as loans made by the funding entity need not result in duplication of flood hazard determinations and borrower notices. The funding entity may delegate to the broker or dealer originating the transaction the responsibility for fulfilling the flood insurance requirements or may otherwise divide the responsibilities with the broker or dealer, as is currently done with respect to the requirements under the Real Estate Settlement Procedures Act (RESPA).

Exemptions to the Purchase Requirement

The flood insurance purchase requirement does not apply to the following two loan situations:

- Loans on state-owned property covered under an adequate policy of self-insurance satisfactory to the Director of FEMA. The Director will periodically publish a list of state property falling within this exemption.
- Loans with an original principal balance of \$5,000 or less, and having an original repayment term of one year or less.

Amount of Flood Insurance Required

The amount of flood insurance required must be at least equal to the outstanding principal balance of the loan or the maximum amount available under the NFIP, whichever is less. The maximum amount available under NFIP is either the dollar limitation indicated below or the value of the structure, whichever is less. Flood insurance coverage does not include the value of the land; rather, it only covers the amount of the insurable structure(s). Institutions may deduct the appraised value of the land from the total amount of the secured property to determine an estimated amount for insurance coverage.

Since March 1, 1995, the limits of coverage for flood policies are:

- \$250,000 for each residential property structure and \$100,000 for personal contents

⁵ See 42 U.S.C. 4012a(b)(1).

- \$500,000 for each non-residential structure and \$500,000 for contents.
Waiting Period

Effective March 1, 1995, the Reform Act increased the waiting period for flood insurance coverage from five days to thirty days. FEMA through Policy Issuance 8-95, dated December 5, 1995, stated that increases in coverage amounts would be subject to the increased waiting period except in the following circumstances:

- When there is an existing policy and an additional amount of insurance is required in connection with the making, increasing, extension, or renewal of a loan, such as a second mortgage, home equity loan, or refinancing,
- When an additional amount of insurance is required as a result of a map revision,
- When an additional amount of insurance is being obtained in connection with the renewal of an existing policy, or
- When flood insurance is required as a result of a lender determining that a loan that does not have flood insurance coverage should be protected by insurance (forced placement).

Special Situations - Second Mortgages/Home Equity Loans

Both second mortgages and home equity loans are transactions that come within the purchase provisions of the FDPA. Since only one flood insurance policy can be issued for a building, an institution should not request a new flood insurance policy if one already exists. Instead, the institution should have the borrower contact the insurance agent:

- to inform the agent of the intention to obtain a loan involving a subordinate lien,
- to obtain verification of the existence of a flood insurance policy, and
- to check whether the amount of insurance covers all loan amounts.

After obtaining this information, the insurance agent should increase the amount of coverage, if necessary, and issue an endorsement that will reflect the institution as a lien holder.

For loans with approved lines of credit that will be used in the future, it may be difficult to calculate the amount of insurance for the loan since the borrower will be drawing down differing amounts on the line at different times. In those instances where there is no policy on the collateral, the borrower must, at a minimum, obtain a policy as a requirement for drawing on the line. As a matter of administrative convenience, an institution may take the following alternative approaches:

- Review its records periodically so that as draws are made against the line or repayments made to the account, the appropriate amount of insurance coverage can be maintained; or
- Upon origination, require the purchase of flood insurance for the total amount of the loan or the maximum amount of flood insurance coverage available, whichever is less.

Other Special Situations

Multiple Structures--Generally, multiple structures that secure a loan located in an SFHA must each be covered by flood insurance, even though the value of one structure may be sufficient to cover the loan amount. FEMA does permit borrowers to insure nonresidential buildings using one policy that includes a schedule separately listing each building. Loans secured by agricultural properties and improvements may be particularly assisted through this practice.

The issue of multiple structures is particularly important to Farm Credit System institutions. Unlike residential lending where most of the value of the collateral is concentrated in a single residence, the value of the collateral in agricultural lending is concentrated not only in the land, but also in multiple agricultural structures. While it may be difficult to value agricultural buildings for flood insurance purposes, the regulations under § 614.4930 require all buildings securing a loan meeting the three basic requirements to be covered by flood insurance. Some agricultural buildings have valuable utility to the farm operation, but have relatively nominal market value. Other buildings may have a higher market value but comprise a relatively low percentage of the total loan collateral. While many agricultural buildings would suffer little damage in a flood, the requirements in the Reform Act did not differentiate agricultural loans from other types of loans. Therefore, all buildings must be covered by flood insurance if securing a designated loan, regardless of the susceptibility to flood damage. However, the NFIP does allow borrowers to insure multiple nonresidential buildings that secure a single loan using either one policy that includes a schedule listing the individual buildings, or separate policies for each building.

Another situation where there may be confusion on how much flood insurance is required by the NFIP and FCA regulations is when multiple agricultural buildings located throughout a large geographic area are securing a single loan. Some of the properties may be located within an SFHA while others are not. In addition, the buildings may be located in several jurisdictions or counties where some of the communities participate in the NFIP, and others do not. The examiners may run across this particular scenario when reviewing large cooperative loans. The amount of insurance required will depend upon the principal amount of the loan, the value of the buildings located in participating communities, and the amount of insurance available under the NFIP.

For example, let's assume a loan in the principal amount of \$750,000 is secured by five buildings, three of which are located in SFHAs within participating communities. The properties are nonresidential in nature; therefore the maximum amount of insurance available under the NFIP is \$500,000 per building. Each of the three buildings located in SFHAs must be covered by flood insurance. The total required amount of flood insurance for the three buildings would be the lesser of \$750,000 or the value of the three buildings. The amount of required flood insurance could be allocated among the three buildings in varying amounts, so long as each is covered by flood insurance.

Other Real Estate Owned--An institution with other real estate owned (OREO) in flood hazard areas should, as a prudent practice, purchase flood insurance policies on its OREO property, although it is not required to do so by the regulation.

Escrow Requirements § 614.4935

An institution must require the escrow of flood insurance premiums for loans secured by "residential improved real estate" if it requires the escrow of other funds to cover other charges associated with the loan, such as taxes, premiums for hazard or fire insurance, or other fees. Depending on the type of loan, the escrow account for flood insurance premiums may be subject to section 10 of RESPA, 12 U.S.C. 2609,⁶ which generally limits the amount that may be maintained in escrow accounts for consumer mortgage loans, and requires escrow account statements. RESPA escrow requirements apply to "Federally related mortgage loans," a category of loans that is narrower in scope than the Reform Act's "residential improved real estate." Therefore, escrow accounts established for Federally related mortgage loans must

comply with the requirements of section 10 of RESPA. However, an escrow account for "residential improved real estate" that is not also a "Federally related mortgage loan" need not comply with section 10 of RESPA, even though the escrow requirements of the Reform Act apply.

⁶ The regulations of the Department of Housing and Urban Development (HUD) implementing section 10 appear at 24 CFR 3500.17 (1995); see also 60 FR 8812 (Feb. 15, 1995), 60 FR 24734 (May 9, 1995), 61 FR 13232 (Mar. 26, 1996) and 61 FR 29238 (June 7, 1996) (revising § 3500.17).

The escrow provisions are designed to improve compliance with flood insurance requirements by ensuring that homeowners located in special flood hazard areas obtain and maintain flood insurance for the life of the loan. However, the Reform Act itself does not restrict the flood insurance escrow requirement to consumer mortgage loans. The determinative factor in the coverage of the escrow requirement is not the purpose of the loan, but the purpose of the building -- whether it is used primarily for residential purposes or for other purposes. Because the Reform Act defines "residential improved real estate" as "improved real estate for which the improvement is a residential building," the escrow provisions cover, for example, multi-family properties containing five or more residential units.

Types of escrow accounts covered

The escrow requirement does not apply if the institution does not require other escrows to be maintained. An escrow arrangement is generally considered voluntary if the policies of the institution do not require the establishment of an escrow account in connection with the particular type of loan. In determining whether an escrow account arrangement is voluntary, it is appropriate to look to the loan policies and practices of the institution and the contractual agreement underlying the loan. If the loan documentation permits the institution to require an escrow account, and its loan policies normally would require an escrow account for a loan with particular characteristics, an escrow account in connection with such a loan generally would not be considered to be voluntary.

In the preamble to the final rule, the agencies noted that HUD takes the position that voluntary payments for credit life insurance do not constitute escrows for purposes of RESPA.⁷ Therefore, the agencies have also determined that payments for credit life insurance and similar types of contracts should not trigger the escrow of flood insurance premiums.

Standard Flood Hazard Determination Form § 614.4940

When an institution makes, increases, extends, or renews any loan secured by improved real estate or by a mobile home, it must use the standard flood hazard determination form (SFHDF) developed by FEMA⁸ to determine whether the building or mobile home offered as security property is or will be located in an SFHA in which flood insurance is available under the Act. An institution can use a printed, computerized or electronic form. It must retain a copy of the completed form, in either hard copy or electronic format, for the period of time it owns the loan. FEMA has stated that if an electronic format is used, the format and exact layout of the SFHDF is not required, but the fields and elements listed on the form are required. Any electronic format used by an institution must contain all mandatory fields indicated on the SFHDF.

Decisions as to the applicability of flood insurance may not be based on an institution's unilateral determination of elevations at which floods may occur. Official elevation determinations and, therefore, map revisions or amendments (LOMAs or LOMRs) may only be performed by FEMA.

Flood maps and Standard Flood Hazard Determination forms may be obtained from FEMA by writing to:

Federal Emergency Management Agency

Flood Map Distribution Center
6930 (A-F) San Tomas Road
Baltimore, MD 21227-6227
or calling: 1-800-358-9616 or 1-800-611-6125

⁷ See 60 FR 24733 (May 9, 1995) (revising 24 CFR 3500.17).

⁸ Available by written request to FEMA, P.O. Box 2012, Jessup, MD 20794-2012

Community status information is no longer published in the *Federal Register*. Institutions may obtain a community status book by contacting a FEMA representative at 1-800-358-9616 to request. Information on community status is also available on the World Wide Web at <http://www.fema.gov/fema/finifp.html>.

Reliance on prior determination

The Reform Act permits an institution to rely on a prior determination, whether or not the security property is located in an SFHA, and it is exempt from liability for errors in the previous determination if:

- the previous determination is not more than seven years old, and
- the basis for the previous determination was recorded on the SFHDF mandated by the Reform Act.

There are, however, two circumstances in which an institution may not rely on a previous determination if:

- FEMA's map revisions or updates show that the security property is now located in an SFHA, or
- the lender contacts FEMA and discovers that map revisions or updates affecting the security property have been made after the date of the previous determination.

The Reform Act also states that an institution can rely on a previous determination set forth on an SFHDF only when it increases, extends, renews or purchases a loan, not when it makes a loan. However, the preamble to the final rule indicates that the agencies will treat subsequent transactions by the same institution with respect to the same property, such as assumptions, refinancings and second lien loans, as renewals. A new determination would, therefore, not be required in those limited circumstances, assuming the other requirements are met.

Forced Placement Requirements § 614.4945

The Reform Act does not require an institution to monitor for map changes, and the final rule does not require that determinations be made at any time other than when a loan is made, increased, extended, or renewed. If, however, at any time during the life of the loan the institution or its servicer determines that required flood insurance is deficient, the final rule requires initiation of forced placement procedures.

The Reform Act imposed the requirement on an institution or a servicer acting on its behalf to purchase or "force place" flood insurance for the borrower if the institution or the servicer determines that coverage is lacking. The final rule, therefore, provides that an institution or servicer must, upon discovering that security property is not covered by an adequate amount of flood insurance, purchase flood insurance in the appropriate amount on the borrower's behalf after providing notice and an opportunity for the borrower to obtain the necessary amount of

flood insurance.

An institution or its servicer continues to be responsible for ensuring that where flood insurance was required at origination, the borrower renews the flood insurance policy and continues to renew it for as long as flood insurance is required for the security property. If a borrower allows a policy to lapse when insurance is required, the institution or its servicer is required to commence force placement procedures.⁹

Forced placement should not be necessary at the time an institution makes, increases, extends, or renews a loan, when it is obligated to require that flood insurance be in place prior to closing. Rather, forced placement authority is designed to be used if, over the term of the loan, the institution or its servicer determines that flood insurance coverage on the security property is deficient; that is, whenever the amount of coverage in place is not equal to the lesser of the outstanding principal balance of the loan or the maximum stipulated by statute for the particular category of structure securing the loan. The amount that must be force placed is equal to the difference between the present amount of coverage and the lesser of the outstanding principal balance or the maximum coverage limit.

There is no required specific form of notice to borrowers for use in connection with the forced placement procedures. An institution or its servicer may choose to send the notice directly or may use the insurance company that issues the forced placement policy to send the notice. FEMA has developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with forced placement procedures. For information concerning the contents of the notification letters used under the MPPP, lenders and others should consult FEMA's MPPP Notice.¹⁰

Determination Fees § 614.4950

An institution or its servicer may charge a reasonable fee to the borrower for the costs of making a flood hazard determination under the following circumstances:

- a borrower initiates a transaction (making, increasing, extending, or renewing a loan) that triggers a flood hazard determination,
- there is a revision or update of flood plain areas or risk zones by FEMA,
- the determination is due to FEMA's publication of a notice that affects the area in which the loan is located, or
- the determination results in the purchase of flood insurance under the forced placement provision.

The preamble to the final rule indicates that the authority to charge a borrower a reasonable fee for a flood hazard determination extends to a fee for life-of-loan monitoring by either the institution, its servicer, or by a third party, such as a flood hazard determination company.

Truth in Lending Act Issues

The Official Staff Commentary to Regulation Z states that a fee for services that will be performed periodically during the loan term is a finance charge, regardless of whether the fee is imposed at closing, or when the service is performed. This would include the fee for life-of-loan monitoring. The fee for the determination of whether a security property is in a SFHA is excluded from the finance charge. The Commentary further indicates that any portion of a fee that does not relate to the initial decision to grant credit must be included in the finance charge.¹¹ If creditors are uncertain about what portion of a fee is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.

Notice Requirements § 614.4955

The final rule requires that when the security property is or will be located in a SFHA, the institution must provide a written notice to the borrower and the servicer. This notice must be provided regardless of whether the security property is located in a participating or non-participating community. The written notice must contain the following information:

- a warning that the building or mobile home is or will be located in a SFHA;

⁹ The insurance carrier should notify the institution or its servicer, along with the borrower when the insurance contract is due for renewal. The insurance carrier also notifies these parties if it has not received the policy renewal.

¹⁰ Notice by FEMA, 60 FR 44881 (August 29, 1995).

¹¹ See 12 CFR part 226, supplement 1, comment 4(c)(7)-3.

- a description of the flood purchase requirements contained in §102(b) of the FDPA, as amended;
- a statement whether flood insurance coverage is available under the NFIP and may also be available from private insurers; and
- a statement whether Federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a Federally declared disaster.

The final rule permits an institution to use the sample form contained in Appendix A to the regulation to comply with the notice requirement. The sample form contains only information required under the regulation. Lenders may personalize, change the format of, or add information to the sample form. However, to ensure compliance with the notice requirements, a lender-revised form must provide the borrower, at a minimum, the information required by regulation. Delivery of the notice must take place within a "reasonable time" before the completion of the transaction. What constitutes "reasonable" notice will vary according to the circumstances of particular transactions. However, the notice should be timely enough to ensure that:

- the borrower has the opportunity to become aware his/her responsibilities under the NFIP; and
- where applicable, the borrower can purchase flood insurance before completion of the loan transaction.

The preamble to the final rule states that the agencies generally regard 10 days as a "reasonable" time interval. Each institution must retain a record of the receipt of the notice by the borrower and the servicer for the period of time the institution owns the loan. The final rule permits an alternate notice provision, whereby an institution may rely on assurances from a seller or lessor that the seller or lessor has provided the requisite notice to the purchaser or lessee. The institution must retain a record of the written assurance from the seller or lessor for the period of time the institution owns the loan. The records of receipt provided by the borrower and the servicer may be retained in the form that best suits the institution's business. Institutions who retain these records electronically must be able to retrieve them within a reasonable time.

Notice to Servicer

The Reform Act added loan servicers to the entities that must be notified of special flood

hazards. In many cases the servicer's identity will not be known until well after the closing; consequently, notification to the servicer in advance of the closing would not be possible or would serve no purpose. In recognition that the servicer is often not identified prior to closing, the preamble to the final rule requires notice to the servicer as promptly as practicable after the institution provides notice to the borrower. It also provides that notice to the servicer must be given no later than at the time the lender transmits to the servicer other loan data concerning hazard insurance and taxes. The final rule explicitly states that delivery of a copy of the borrower's notice to the servicer suffices as notice to the servicer.

Notice of Servicer's Identity § 614.4960

An institution must notify the Director of FEMA, or the Director's designee, of the identity of the loan servicer and of any change in the servicer. FEMA has designated the insurance carrier as its designee to receive notice of the servicer's identity and of any change therein. Notice of the identity of the servicer of each loan will enable FEMA's designee to provide notice to that servicer 45 days before the expiration of a flood insurance contract on any loan.

The final rule requires that notice of a change in servicer be sent within 60 days of the effective date of the transfer of servicing. No standard form of notice is required to be used, however, in the preamble to the final rule, the agencies stated that the information should be sufficient for the Director, or the Director's designee, to identify the security property and the loan, as well as the new servicer and its address.

Penalties and Liabilities

The Reform Act revised the FDPA to provide penalties for violations of:

- escrow requirements;
- notice requirements; and
- forced placement requirements.

If an institution is found to have a pattern or practice of committing violations, the Reform Act requires agencies to assess civil penalties in an amount not to exceed \$350 per violation with a total amount against any one regulated institution not to exceed \$100,000 in any calendar year. Any penalty assessed must be paid into the National Flood Mitigation Fund. Liability for violations cannot be transferred to a subsequent purchaser of a loan. Liability for penalties expires four years from the time of the occurrence of the violation.

Examination Objectives

1. Verify that adequate controls exist to reasonably ensure the institution complies with flood insurance requirements.
2. Determine whether an institution performs required flood determinations for loans secured by improved real estate or mobile homes affixed to permanent foundations in accordance with the final rule.
3. Determine if the institution requires flood insurance in the correct amount when it makes, increases, extends, or renews loans secured by improved real estate or a mobile home located or to be located in SFHAs located in communities participating in the NFIP.
4. Determine if the institution provides the required notices to the borrower, servicer and to the Director of FEMA whenever flood insurance is required as a condition of the loan.
5. Determine if the institution requires flood insurance premiums to be escrowed when flood insurance is required on a residential building and funds to cover other charges associated with the loan are required to be escrowed.

6. Determine if the institution complies with the forced placement provisions if, at any time during the term of a loan, it determines that flood insurance on the loan is not sufficient to meet the requirements of the regulation.
7. Initiate corrective action when policies or internal controls are deficient, or when violations of law or regulation are identified.

Examination Procedures

The following procedures should be performed, as appropriate:

Coverage and Internal Control

1. Determine the method(s) used by the institution to ascertain whether improved real estate or mobile homes are or will be located in SFHAs.
2. Verify that the process used accurately identifies SFHAs.
3. For those SFHAs identified, determine if the communities in which they are located participate in the NFIP.
4. If the institution provides "table funding" to close loans originated by mortgage brokers or dealers, verify that it complies with regulatory requirements.
5. If the institution purchases servicing rights, review the contractual obligations placed on the institution as servicer by the owner of the loans to ascertain if flood insurance requirements are identified and compliance responsibilities are adequately addressed.
6. If the institution utilizes a third party to service loans, review the contractual obligations between the parties to ascertain that flood insurance requirements are identified and compliance responsibilities are adequately addressed.

Property Determination Requirements

1. Verify that flood zone determinations are accurately prepared on the SFHDF.
2. Verify that the institution only relies on a previous determination if it is not more than seven years old, is recorded on the SFHDF and that it is not in a community that has been remapped.
3. If the institution utilizes a third party to prepare flood zone determinations, review the contractual obligations between the parties to ascertain that flood insurance requirements are identified and compliance responsibilities are adequately covered, including the extent of the third party's guarantee of work and the procedures in place to resolve disputes relating to determinations.
4. Verify that the institution retains a copy of the completed SFHDF, in either hard copy or electronic form, for as long as it owns the loan.

Purchase Requirements

1. For loans that require flood insurance, determine that sufficient insurance was obtained prior to loan closing and is maintained for the life of the loan.
2. If the institution makes loans insured or guaranteed by a government agency (SBA, VA or

FHA), determine how it complies with the requirement not to make such loans if the security property is in an SFHA within a non-participating community.

Determination Fee Requirements

1. Determine that any fees charged to the borrower by the institution for flood zone determinations (absent some other authority such as contract language) are charged only when:
 - a loan is made, increased, renewed or extended;
 - there is a revision or update of flood plain areas or risk zones by FEMA;
 - the determination is due to FEMA's publication of a notice that affects the area in which the loan is located, or
 - the determination results in the purchase of flood insurance under the forced placement provisions.
2. If other authority permits the institution to charge fees for determinations in situations other than the ones listed above, determine if the institution is consistent in this practice.
3. Determine the reasonableness of any fees charged to a borrower for flood determinations by evaluating the method used by the institution to determine the amount of the charge. Consider, for example, the relationship of the fees charged to the cost of services provided.

Notice Requirements

1. Ascertain that written notice is mailed or delivered to the borrower within a reasonable time prior to loan closing.
2. Verify that the notice contains:
 - a warning that the property securing the loan is or will be located in a SFHA;
 - a description of the flood insurance purchase requirements;
 - a statement , where applicable, that flood insurance coverage is available under the NFIP and may also be available from private insurers; and
 - a statement whether Federal disaster relief assistance may be available in the event of damage to the property caused by flooding in a Federally declared disaster, if applicable.
3. If the seller or lessor provided the notice to the purchaser or lessee, verify that the institution obtained satisfactory written assurance that the notice was provided within a reasonable time before the completion of the sale or lease transaction.
4. Verify that the institution retains a record of receipt of the notice provided to the borrower for as long as it owns the loan.
5. If applicable, verify that the institution provided written notice to the servicer of the loan within the prescribed time frames and that the institution retains a record of receipt of the notice for as long as it owns the loan.
6. If the institution transfers servicing of loans to another servicer, ascertain whether it provides notice of the new servicer's identity to the flood insurance carrier (Director of FEMA's

designee) within the prescribed time frames.

Escrow Requirements

1. If the institution's policies or loan documents require the escrow of funds to cover charges such as taxes, premiums for hazard insurance or other fees, verify that the institution requires the escrow of funds on loans secured by residential improved real estate to cover premiums and other charges associated with flood insurance.
2. For loans closed after October 1, 1996, where flood insurance is required and where the loan is subject to RESPA, verify that the institution's escrow procedures comply with Section 10 of RESPA.

Forced Placement Requirements

1. If the institution determines that flood insurance coverage is less than the amount required by the FDPA, ascertain that it has appropriate policies and procedures in place to exercise its forced placement authority.
2. If the institution is required to force place insurance, verify that:
 - it provides written notice to the borrower that flood insurance is required; and
 - if the required insurance is not purchased by the borrower within 45 days from the time that the institution provides the written notice, the institution purchases the required insurance on the borrower's behalf.