A. INTRODUCTION

The 1994 National Flood Insurance Reform Act (the 1994 Reform Act) is part of Title V of the Riegle Community Development and Regulatory Improvement Act of 1994 and amended 42 U.S.C. §4001 et seq. The 1994 Reform Act imposes significant new obligations on lenders and servicers and tightens the requirements on the receipt of disaster assistance.

1. Brief Description of the National Flood Insurance Program

Prior to 1968, the Federal Government attempted to control coastal and riverine flooding on a national scale through re-channeling, using dams and levees to restrict the flow of waters, as well as through development of hydroelectric power and irrigation. But the increasing costs of these projects and high annual totals of flood-related damage influenced the Government to explore the possibility of decreasing disaster relief payments through flood insurance.

In spite of all these actions, vast sums of money continued to be expended through the response mechanism of Federal disaster assistance. From the standpoint of the Federal Government, the question to be decided was through which mechanism Federal funds would be made available most effectively after a flood, i.e., disaster assistance or flood insurance payments.

In 1968, flood insurance coverage was virtually unavailable in the private sector. The private insurance industry was then, and remains now, largely unwilling to underwrite and bear the risk of flood because of its catastrophic nature. Consequently, Congress decided to provide coverage through a Federal flood insurance program to help reduce the costs of expensive disaster relief payments.

Through the National Flood Insurance Act of 1968, Congress authorized the National Flood Insurance Program (NFIP), which provided an opportunity for property owners to purchase flood insurance protection made available by the Federal Government for structures and contents. The NFIP combines the concepts of insurance protection and hazard mitigation. This Program provides an incentive for communities to adopt floodplain management ordinances to mitigate the effects of flooding upon new or existing construction. (Citations referring to the statutory authority of the Program can be found in Appendix 1.)

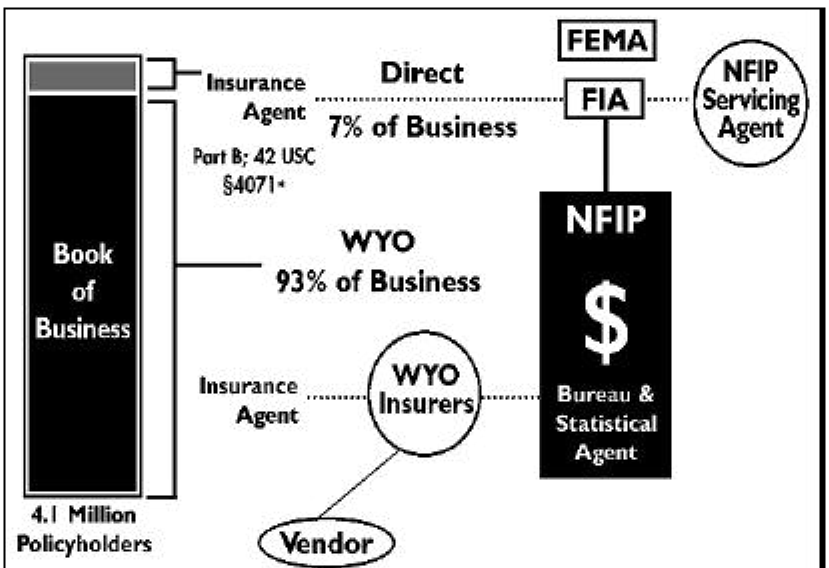
The 1968 Act made federally subsidized flood insurance available to owners of improved real estate or mobile homes located in a floodplain if their community participated in the NFIP. The Act defines improved real estate as real estate upon which a building is located. Under the NFIP, this means a walled and roofed building or a building in the course of construction that qualifies for insurance coverage. The term "improved real estate," as used throughout these guidelines, includes mobile homes, unless otherwise stated.

A community establishes its eligibility to participate in the NFIP in two ways:

- By adopting and enforcing floodplain management measures to regulate new construction, and
- By ensuring that substantial improvements to existing buildings within identified Special Flood Hazard Areas (SFHAs) are designed to eliminate or minimize future flood damage.

An SFHA is an area within a floodplain having a 1 percent or greater chance of flood occurrence in any given year. SFHAs are delineated on flood maps issued by the Federal Emergency Management Agency (FEMA) for individual communities. These flood zones are represented on the flood maps by the darkly shaded areas with zone designations that include the letter A or V.

Federal flood insurance was initially available only through insurance agents who dealt directly with the Federal Insurance Administration (FIA). This "direct" policy program has been supplemented since 1983 with a program known as "Write Your Own (WYO)," through which more than 100 insurance companies, based on an arrangement with the FIA, issue policies and adjust flood claims under their own names. The insurers receive an expense allowance and remit premium income in excess of claims to the Federal Government. The FIA pays losses in excess of premiums and sets the rates, coverage limitations, and eligibility requirements. The premium charged for NFIP flood coverage by a WYO Company is the same as that charged by the Federal Government through the direct program.



This chart demonstrates the two methods available, i.e., Direct and WYO, to obtain NFIP coverage.

2. The Mandatory Flood Insurance Purchase Requirement

a. Flood Disaster Protection Act of 1973

From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance was voluntary. Property owners could make their own decisions whether to purchase flood insurance. However, the 1973 Act mandated flood insurance coverage for many properties. For the first time, regulated lending institutions could not make, increase, extend, or renew any loan secured by improved real estate or located in an SFHA in a participating community unless the secured building and any personal property securing the loan were covered for the life of the loan by flood insurance. This measure was necessary because, after major flooding disasters, it became evident that relatively few individuals in eligible communities who sustained flood damage had purchased flood insurance. An eligible community is a political subdivision with the authority to enact regulations in identified SFHAs. Although nearly all the eligible communities are now in the Program, fewer than 25 percent of the eligible buildings are actually covered by flood insurance policies. Market penetration is highly variable from community to community. As shown by past disasters, coverage has been lower than 10 percent in some communities and as high as 75 percent in certain coastal communities.

Overall, history has proven that voluntary participation, as well as a mandatory program with weak sanctions, yields too few subscribers.

b. National Flood Insurance Reform Act of 1994

Following the multi-billion dollar flood damage in the Midwest during the summer of 1993, Congress revisited the mandatory purchase law and enacted the 1994 Reform Act. The reasons for the Reform Act included the NFIP's low reserves, resulting from a series of storms, as well as a low level of participation among eligible property owners. At that time, it was estimated that slightly more than 2 million of the 10 million households in SFHAs were covered by flood insurance. This low level of coverage persisted for various reasons, including the following:

- Some homeowners believed that they simply could not afford the cost of flood insurance in addition to mortgage payments and homeowners' insurance.
- Federally regulated lending institutions often were relaxed in complying with the mandatory purchase provision without the sanction of a penalty.
- Homeowners who purchased flood insurance at the origination of their mortgages often allowed their policies to lapse.

A combination of these factors led to a low percentage of eligible homeowners purchasing flood insurance and kept disaster relief payments high. Congress recognized that the proper response was to bring more property owners into the Program by creating more inducements to purchase coverage.

Congressional activity culminated with the passage of H.R. 3474, which was enacted as 103 P.L. 325, Title V, 108 Stat. 2160, 2255-87 (Sept. 23, 1994), generally referred to as the 1994 Reform Act. The Conference Committee's report that accompanies the legislation at H.R. Conf. Rep. No. 652, 103rd Cong. 2d Sess. 195 (1994) (Conference Report) describes the reasons for the amendments to the Act.

As stated in the report, the legislation contains important reforms to improve the financial condition of the NFIP. A primary purpose of the legislation is to improve compliance with the mandatory purchase requirements of the NFIP by lenders, servicers, and secondary-market purchasers. Improved program compliance will increase participation nationwide by those individuals who have mortgaged homes or businesses in SFHAs, but have not purchased or maintained flood insurance coverage. Increasing compliance and participation in the NFIP is also designed to provide additional income to the insurance fund and decrease the financial impact of flooding to the Federal Government, to taxpayers, and to citizens in areas prone to flooding.

The law requires Federal agency lender regulators to develop regulations to direct their federally regulated lenders not to make, increase, extend, or renew any loan on applicable property unless flood insurance is purchased. The proposed regulations were jointly issued in the October 18, 1995, Federal Register at Vol. 60, No. 201, p.53962; the final regulations appeared in the August 29, 1996, Federal Register at Vol. 61, No. 169, p.45683. A version of the regulations is attached as Appendix 2. Most of the final regulations have an effective date of October 1, 1996. Exceptions are the implementation of the Farm Credit Administration regulations, with an effective date of October 4, 1996, and the National Credit Union Administration regulations, with an effective date of November 1, 1996.

In response to numerous requests for additional information, the agencies will issue informal guidance to address technical issues after the promulgation of the joint final regulations.

The centerpiece of the mandatory purchase requirements is found in the statute at 42 U.S.C. §4012a(b) (see Appendix 3). Certain notice requirements that complement these substantive requirements are found at 42 U.S.C. §4104a and §4104b (see Appendix 4). These sections address the responsibility of regulated lending institutions and Government-Sponsored Enterprises (GSEs) in providing notice of and requiring flood insurance coverage for the term of the loan on buildings located in any SFHA in participating communities.

The 1994 Reform Act significantly tightens the 1973 Act by imposing important new obligations on both mortgage originators and servicers, including mandatory escrow requirements for flood insurance and mandatory provisions for "forced place-ment" of flood insurance.

Although the intent of the statute is to require borrowers to purchase flood insurance, the 1994 Reform Act's directives and prohibitions are directed to federally regulated primary lenders and to secondary market entities involved in mortgage loan transactions. The flood insurance requirements do not apply to lenders or servicers that are not federally regulated and that do not sell loans to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) or other GSEs. The 1994 Reform Act indirectly impacts regulated and unregulated lender security, because borrowers who have received certain disaster assistance and then fail to obtain and maintain flood insurance coverage are barred from receiving future disaster assistance.

The 1994 Reform Act makes it clear that the requirement to purchase flood insurance is not to be waived for those recipients of Federal disaster assistance who continue to remain uninsured, thereby increasing the chances they will need Federal disaster assistance again. Removing the availability of disaster assistance thus encourages individuals to purchase flood insurance rather than have no funds available when a loss occurs. Disaster assistance for temporary housing and for purposes other than repairing or rebuilding buildings is not affected by this new provision.

A key clarification of the 1994 Reform Act is that flood insurance must be obtained and maintained during the term of the loan. This provision also applies to Fannie Mae and Freddie Mac on any "covered loan" they buy. Flood insurance will be required even if the SFHA designation is first identified after settlement, but during the term of the loan. This requirement is designed to combat coverage lapses allowed to occur by individuals who believe they will not be flooded, and therefore discontinue payment of flood insurance premiums during the term of the loan.

It is a prerequisite that a designated loan have flood insurance as a condition of closing. If a borrower will not voluntarily obtain coverage and a lender is unable to force place coverage, the lender must deny the loan or exercise the sanction provisions of the loan document if the loan already has been made. A lender cannot accept a borrower's assurance that he or she will obtain coverage in the future or grant the lender indemnity while seeking coverage.

Closing a designated loan without coverage in place constitutes a violation of the regulation.

The 1994 Reform Act is designed to strengthen compliance with mandatory purchase requirements. The Act is applicable when a lien is taken as security for a loan transaction on improved real estate (a building) or a mobile home. Under the new law, lenders' responsibilities include the following actions:

- Determine whether the building offered as security for a loan is, or will be, located in an SFHA;
- Document the determination of flood hazard status;
- Require that flood insurance to the appropriate limit is obtained when necessary; and
- During the term of the loan, ensure that flood insurance is maintained or added if the lender becomes aware that the building involved subsequently becomes part of an SFHA.

While the mandatory purchase requirement applies only to buildings located in SFHAs of participating communities, NFIP flood insurance is available in all areas of participating communities. This is especially significant because, historically, about 25 percent of the NFIP claims paid have actually been outside of SFHAs. Lenders and property owners may wish to exercise additional caution in areas subject to flooding due to storm water, in areas where the NFIP has used approximate methods to map SFHAs, or in remote locations where no SFHAs have been designated by FEMA. In January 1989, to facilitate the purchase of flood insurance outside of SFHAs, the NFIP began offering a low-cost "preferred risk" policy for buildings located in Zones B, C, and X.

Some buildings in a participating community may be ineligible for flood insurance because of statutory restrictions or NFIP underwriting rules. See Section B.2.d for a discussion of the unavailability of flood insurance in such instances.

The 1994 Reform Act's mandatory purchase requirement applies to all federally backed loans outstanding on or after the date of the Act's enactment, September 23, 1994. The Conference Committee, in its report on the Act, states its view that the making, increasing, extending, or renewing of a loan serves as a "tripwire" of sorts for compliance with the flood insurance purchase requirements. In the modern mortgage marketplace, this approach makes compliance by lenders increasingly more likely, as borrowers obtain new loans on existing buildings or refinance existing loans. At each designated "tripwire" in the mortgage process, the legislative intent is for a lender or servicer to ensure that flood insurance is purchased and maintained.

A requirement for flood insurance on secured property that is not subject to the Federal flood insurance statutes is a matter of contract between the lender and borrower.

B. COVERAGE AVAILABILITY

1. Participating Communities

a. Community Ordinances

FEMA conducts Flood Insurance Studies throughout the United States, in cooperation with community officials, to determine the location of Special Flood Hazard Areas (SFHAs) in each community. Based on these studies, FEMA issues Flood Hazard Boundary

Maps (FHBMs) or Flood Insurance Rate Maps (FIRMs) showing the location of these areas and notifies each community of the determination.

Following notification from FEMA that flood hazards exist, if a community decides to participate in the NFIP, it enters into an agreement with FEMA. Under this agreement, the community adopts and enforces ordinances designed to reduce the risk of buildings in that community being damaged by flooding. These ordinances restrict development or limit imprudent building within designated flood hazard areas. In exchange, NFIP flood insurance becomes available for most residential and commercial buildings in the community.

The community's floodplain management ordinances must require building permits for all development within the SFHA. New and substantially improved residential buildings must be constructed with the lowest floor at or above the base flood elevation (BFE), if shown on the FIRM. Nonresidential buildings can be either elevated or floodproofed (made watertight) to that elevation.

Participating communities that fail to adequately enforce their floodplain management ordinances may be placed on probation if they do not take corrective actions within a specified time. NFIP policyholders in that community will be notified that probation is pending and that their policies may become subject to a surcharge on their flood insurance premiums. If a community fails to bring its floodplain management program into compliance with the NFIP requirements, it may be suspended from the NFIP, which would terminate its status as a participating community. In that event, NFIP policies would not be renewed for property owners in that community, no new policies would be issued, and Federal disaster assistance would be limited.

Most suspended communities quickly enforce the ordinances and become participating again. The success of the NFIP's growth can be credited in part to the incentive that promotes the receipt of Federal benefits contingent upon the implementation of land use controls at the local level.

The NFIP also has special provisions for those communities whose floodplain management activities go beyond the minimum required by law. The Community Rating System (CRS), codified in the 1994 Reform Act, provides incentives in the form of reduced insurance premiums to communities that voluntarily adopt and enforce measures exceeding current program criteria to reduce the risk of flood damage.

b. Studies and Maps

More than 19,000 communities susceptible to flooding have been identified through the publication of flood maps by FEMA. Over 95 percent of these communities participate in the NFIP. Property owners throughout the participating communities are eligible to purchase the maximum amount of flood insurance available under the NFIP to protect buildings located anywhere within such communities, both inside and outside of SFHAs (subject to other restrictions discussed below). Relatively few communities with the potential for flooding do not presently participate. A small percentage of communities are currently "suspended" from the program.

A few participating communities remain in the Emergency Program phase, where only limited amounts of insurance are available. The applicable map for these communities is the FHBM. Once a FIRM has been developed and issued, it replaces the FHBM. At that time, these communities are eligible for conversion to the Regular Program phase and, therefore, eligible for the maximum amounts of insurance coverage available under the NFIP.

The official FIRM for a Regular Program community delineates the SFHAs and the applicable flood insurance risk zones. SFHAs are those areas within the floodplain that have a 1-percent chance of being flooded in any given year (base flood). Over a 30-year period (the life of most mortgages), there is at least a 26-percent chance that property within an identified SFHA will be flooded.

SFHAs are represented on FIRMs by darkly shaded areas designated with the letter A or V. FEMA uses engineering studies to determine the delineation of these areas. SFHAs are defined in the regulations at 44 CFR §59.1 as Zones A, AO, A1-A30, AE, AR, AR/AO, AR/A1-A30, AR/AE, AR/AH, AR/A99, A99, AH, VO, V1-V30, VE, V, M, or E. The A-lettered areas are susceptible to flooding, while the V-lettered areas are also subject to wave velocity associated with storm waves or wave action. Older FIRMs show numbered A Zones (e.g., A1, A2, A30) and numbered V Zones (e.g., V1, V2, V30) in lieu of the newer AE and VE Zones. Zone M designates mudslide (i.e., mudflow) hazards, and Zone E designates erosion-prone areas. However, Zones M and E do not appear on the FIRMs. Buildings located in the temporarily designated flood restoration zone (Zone AR) are subject to the mandatory purchase requirement.

The term SFHA does not include areas outside the base flood area. Older maps use Zones B and C to represent areas of moderate and low flood risk. Newer maps have replaced these designations with Zone X (shaded) and Zone X (unshaded), respectively. Areas for which FEMA has made no flood hazard evaluation, but for which flooding is considered possible, are designated as Zone D.

Finally, certain communities with no SFHAs indicated do not have published maps, and the entire area is considered to be in Zone X (unshaded). Although these areas may not be subject to the base flood, local drainage problems may cause damage to certain buildings. If a lender extends a loan in an unmapped participating community and has reason to believe there is a possibility of flood loss to the secured building, then safety and soundness dictate that flood insurance coverage should be in place.

For buildings located outside the SFHAs, the 1994 Reform Act does not require lenders to impose the flood insurance purchase requirement. However, in accord-ance with most mortgage documents' hazard insurance provision, a mortgage lender is free to require a borrower to carry flood insurance, even if the building serving as security for a loan is located outside an SFHA. Flood insurance is available for all eligible buildings in participating communities, whether inside or outside an SFHA.

c. Map Issues

Map issues arise frequently, since the location of a building with respect to an SFHA is central to determining the applicability of the mandatory purchase provision, as well as the insurance premium rate. In theory, the area on a map in which a building is located should reflect its susceptibility to flood; yet, in practice, FHBMs and FIRMs cannot reflect every nuance in the physical geography of an area. This section will review some of the most frequently encountered map issues, including:

- Letters of Map Amendment (LOMAs)
- Letters of Map Revision (LOMRs)
- Community-Initiated Map Revisions
- Map Availability

(1) Letters of Map Amendment

Occasionally, a flood map will show property as clearly being in an SFHA, even though the building on the property is actually above the BFE. In practice, FHBMs and FIRMs cannot possibly reflect every rise in terrain, and there will be instances of "natural islands" of high ground that are inadvertently included in the SFHAs. Nevertheless, until the map is physically revised, lenders are bound by the information shown on FEMA maps unless a valid Letter of Map Amendment (LOMA) or Letter of Map Revision (LOMR) has been issued by FEMA for the property. Lenders may not close a loan based on a guarantee, or indemnification from a flood vendor or other third party, as a substitute for a LOMA or LOMR.

However, a mechanism is available for resolving such a situation. A property owner can submit property and elevation materials in support of a request for a LOMA removing the property from the SFHA. This process involves the property owner and FEMA.

(2) Letters of Map Revision

A different, but related, situation is presented when a property owner, whose land is within an SFHA below the BFE, grades and fills the site to raise the level of the land above the BFE. In the LOMA situation described previously, the natural level of the land at the time the map was issued was above the BFE, and no artificial improvement was needed to accomplish that level. In cases where physical changes were necessary to raise the structure above the BFE, FEMA will not issue a LOMA. However, with the community's concurrence, FEMA will issue a Letter of Map Revision Based on Fill (LOMR-F) that, for the purposes of the property owner, will accomplish the same objective. A LOMR-F also can be used to correct a mistake made in the original analysis or to reflect changed conditions, such as the construction or removal of a dam or other flood control structure.

The request for a LOMR must be initiated or approved by the community. Changes in land level may impact other property owners. Submission of a request for a LOMR by the community also confirms that the community has reviewed the change in land level and found it compatible with the community's planning. LOMRs also may be granted in situations where channels have been dug or reservoirs built to reduce BFEs and where levees or floodwalls have been constructed to protect areas. In regulatory floodways, which include the channel of a river and the adjacent floodplain that must be kept unobstructed, the placing of fill or other development is not allowed if it will result in any increase in the flood level for the SFHA.

A unique situation arises when a building is initially constructed at a level below the BFE in an SFHA, and its lowest floor is subsequently elevated or raised above the BFE by supporting walls or pilings. Such a structure is then considered an elevated building by the NFIP.

In this situation, there is no basis for the issuance of either a LOMA or LOMR. The building is still in the designated SFHA, and its foundation can come into direct contact with floodwaters. When an owner of property below the base flood level elevates a building so that the lowest floor is above the base flood level, the flood insurance purchase requirement continues to apply. Insurance is required because the foundation on which the house is elevated is still below the BFE in the SFHA, where it remains exposed to the action of floodwaters. However, because of its reduced exposure to damage, the newly elevated building will be subject to a lower insurance rate and premium.

Only FEMA can amend an official flood map to remove the location of an insurable building from an SFHA, add it to a designated SFHA, change the SFHA boundary or flood insurance risk zone designation, or modify the BFEs on a map. Until a property owner has received a LOMA or LOMR removing the building from the SFHA, the information shown on the effective FHBM or FIRM must be used. Questions concerning the correctness of the map or the proper zone designation of a building's location in accordance with a LOMA or LOMR are matters beyond the authority of the lender.

After obtaining a LOMA or LOMR, the property owner may submit the letter to the lender, requesting a waiver. However, even though lenders are not required to compel the purchase of flood insurance on buildings removed from the SFHA by a LOMA or LOMR, they have the discretionary right to continue to require flood insurance in accordance with their lending documents. Many floods occur outside of designated SFHAs, and nearly 25 percent of flood insurance claims are for buildings located in these low-risk areas. For this reason, owners who are considering seeking a LOMA or LOMR should first consult their lending institutions to determine if flood insurance will still be required. Further, lenders are encouraged to advise LOMA and LOMR recipients that floods more severe than the base flood do occur and that they should consider purchasing a Preferred Risk Policy.

(3) Community-Initiated Map Revisions

A physical map revision is an official republication of a map to effect changes to flood insurance risk zones, floodplain and floodway boundary delineations, flood elevations, and other mapping and boundary features within a community. These changes typically occur as a result of structural works or improvements, annexations resulting in additional flood hazard areas, or corrections of BFEs or flood insurance risk zones. In accordance with the 1994 Reform Act, the Director of FEMA is required to assess the need to update floodplain areas and flood risk zones every 5 years. A notice of any change in BFEs on flood map panels will be published in the Federal Register and in local newspapers.

(4) Map Availability

Under the 1994 Reform Act, FEMA has specific responsibilities for making flood map information available, including the following:

- FEMA must make FIRMs, FHBMs, and related information dealing with the various changes discussed above available free of charge to the Federal entities for lending regulation (Federal lenders and certain other governmental entities), and at a reasonable cost to all other persons. The maps and other NFIP publications are available through

FEMA's Map Service Center, which can be contacted on 1-800-358-9616. (See Appendix 5 for additional resources.)

- FEMA also must provide notice of any change to flood insurance map panels, including changes effected by LOMA or LOMR, not later than 30 days after the map change or revision becomes effective. FEMA must either publish this notice in the Federal Register or provide notice by another comparable method.

- Finally, every 6 months, FEMA must publish a compendium of all changes to FIRM panels, all new FIRM panels, and all LOMAs and LOMRs published during the preceding 6 months. The compendium will show the various changes in which some areas are removed from the SFHA while others are included. This compendium is made part of the public record as published in the Federal Register. A lender should review its loans located within the geographic area(s) impacted by the changes noted in the compendium. If a lender becomes aware that any buildings on which it has loans are brought within an SFHA, the mandatory purchase requirements must be met.

d. Determining Location of a Building

(1) Significance of Building's Location

As stated earlier, the mandatory flood insurance purchase requirements of the 1994 Reform Act apply only where there is a loan extended on improved real property (i.e., a building or mobile home) that is located in an SFHA in a participating community. The require-ment is accomplished by completing the Standard Flood Hazard Determination Form (SFHDF) as discussed in Section C.2.e of these guidelines. If the building or mobile home is located in a participating community, but not in an SFHA, flood insurance is not required, but is available and encouraged.

Even though a portion of real property on which a building is located may lie within an SFHA, the purchase and notice requirements of the 1994 Reform Act do not apply unless the building itself, or some part of the building, is in the SFHA. However, even though that part of the building within the SFHA is not subject to coverage (e.g., a deck) the entire building is considered to be in the SFHA.

Lenders, on their own initiative, may require the purchase of flood insurance even if a building is located outside an SFHA. A decision to require coverage under such circumstances is not compelled by the statute, but is founded on the contractual relationship between the parties. Lenders have the prerogative to require flood insurance to protect their investments, provided that they have reserved that option in their mortgage loan document.

(2) Responsibility in Determining a Building's Location

The 1994 Reform Act sets the ultimate responsibility to place flood insurance on the applicable lender, yet allows for limited reliance on third parties to the extent the information they provide is guaranteed. The lender, servicer, or a third-party vendor may conduct the determination. Under any alternative, the lender, using such evidence as is reasonable, must take the responsibility for making determinations and redeterminations. A financial institution cannot rely on the statements of a borrower that the structure in question is either inside or outside an SFHA.

Lenders may reasonably seek assistance from third parties that have demonstrated their knowledge concerning flood map information. For regulatory purposes, reasonable reliance upon such services in the making of a lender's determination is regarded as acceptable only to the extent "such person guarantees the accuracy of the information," as provided under the statute at 42 U.S.C. §4104b(d).

Some third-party flood zone determi-nation companies also provide a form of life-of-loan service that monitors the flood hazard status of the secured structure for the term of the loan. Third-party life-of-loan service is designed to discover a change in flood hazard status, thereby minimizing administrative burden for the lender or servicer. The law does not require a lender to subscribe to a tracking service that provides life-of-loan monitoring.

A lender must use the FIRM or FHBM to make the determination and may supple-ment with other reliable information to accurately locate the building. In many instances, community officials, insurance company personnel, insurance agents, realtors, surveyors, or appraisers may be helpful and knowledgeable resources. However, due to the extent that such parties cannot, or will not, grant guarantees, reliance upon the information they provide cannot be used for exculpatory purposes if the lender is confronted with a regulatory violation or a civil claim for damages. Regardless of how the determination is reached, the non-delegable obligation of the determination remains the responsibility of the lender.

A lender may rely on a previous determination, not more than 7 years old, when increasing, extending, renewing, or purchasing a loan, only when the previous determination was recorded on a designated SFHDF as mandated by the 1994 Reform Act. This rule does not apply when a new loan is made, or if a map revision causes a building to be located within an SFHA, or if a map change occurs after the date of the previous determination.

The 1994 Reform Act places the regulatory onus on the Federal financial regulatory agencies and GSEs to ensure that the entities under their jurisdiction require the borrowers to meet these requirements and, if coverage is mandated, to require its purchase.

(3) Flood Determination Fee Charged by Lender

The 1994 Reform Act gives a lender or servicer authority to pass on a "reasonable fee" to borrowers when a determination is made in conjunction with either the:

- Making, increasing, extending, or renewing of a loan initiated by the borrower
- Revision or updating of a map
- Required "force placement" of coverage.

Passing along a fee to the borrower is not allowed on a routine portfolio review unless the review results in discovery of a loan for which coverage is specifically required.

When the flood map is revised, or in a special situation when the Director of FEMA determines that an area requires a review, a lender is permitted to conduct a search on its loan portfolio in the affected area and pass through the flood determination fee to all borrowers involved. The pass-through is permitted whether or not it is ultimately shown that coverage is necessary or already in existence on any of the affected buildings. When a search is conducted because of a map change, a reasonable fee may be charged for that service whether the flood zone determination is positive or negative. The 1994 Reform Act does not distinguish between determinations done in-house by a lender or performed by a flood zone determination company. Accordingly, a lender or servicer is entitled to charge a determination fee in either case.

The commentary that accompanied the 1994 Reform Act states that the determination fee may include the life-of-loan charge assessed to monitor the loan for its term. This Act does not specifically define what constitutes reasonableness in evaluating the fee. Also unspecified is whether incidental expenses, cost, or profit margin may be factored into the fee. The amount of the fee remains subject to review on a case-by-case basis by the applicable regulator.

Where an extension of credit is secured by an interest in real property, the Truth in Lending Act and its implementing regulation, Regulation Z, specifically provide that certain costs and fees, if bona fide and reasonable in amount, need to be *disclosed*, but need not be included in the calculation of the finance charge. The Truth in Lending statute provides that a flood zone determination charge is excludable as a finance charge only if it is imposed in connection with the initial decision to grant credit. Therefore, a flood zone search fee that does not contain a charge for life-of-loan monitoring need not be included as part of the finance charge. The fee charged for the initial determination must appear on the HUD Good Faith Estimate, and the actual fee must be disclosed on the HUD-1 Settlement statement.

The Truth in Lending law also requires that a fee for services to be performed periodically during the loan term (for example, the life-of-loan component that is charged to monitor continued compliance) may not be excluded in the calculation of the finance charge regardless of when paid. If a consolidated flood determination fee includes a life-of-loan aspect, which cannot be apportioned between an initial credit decision or future services, the entire charge is to be considered a finance charge. If a lender is 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.

Regulation Z does not come into play if a lender incurs flood zone determination expenses subsequent to the closing of the loan, such as expenses arising from a remapping or the transfer of a fee to the borrower.

Section 4012a(h) of the 1994 Reform Act also contains an express provision that preempts other Federal or State law with respect to flood determination fees charged by lenders.

e. FEMA's Review of Determinations

To determine whether a building is located in an SFHA, it is necessary to examine the location of the building in relationship to the SFHA shown on the FHBM or FIRM. However, despite FEMA's efforts to make the maps as useful as possible, the boundary location of some SFHAs may be difficult to determine precisely. This creates a problem in deciding whether a building on property that is the security for a loan is subject to the mandatory purchase requirement.

To a limited extent, Congress recognized this problem in the 1994 Reform Act. The new law allows for a statutory review process when the question of a building's location arises. Essentially, the law authorizes lenders to require flood insurance protection in conjunction with the loan. Occasionally, a borrower may contest the need for this insurance by contending that the building is not located within an SFHA. Upon request, FEMA will review a determination that has been conducted or obtained by a lender using the current printed map panel, provided the request meets the stipulated criteria. The review provides a forum for borrowers and lenders to resolve disputes regarding contested determi-nations. This procedure is intended to confirm or disprove the accuracy of the original determination. It is not intended to result in the initiation of a LOMA or LOMR or resolve questions concerning the elevation of a building.

If the issue is whether the FIRM or FHBM was read correctly, the administrative determination review procedure is appropriate. If the issue is whether the FIRM or FHBM should be changed, LOMA, LOMR, or LOMR-F procedures are appropriate. If the determination review process indicates that the building is in the SFHA, FEMA will notify the requestor of the determination review that other procedures are available to individuals under Parts 70 and 65 of the NFIP regulations. The review procedure is found at 42 U.S.C. §4012a(e)(3)(A) of the law, with the regulations located at 44 CFR §65.17.

(1) Statutory Review

(a) Initiation Procedures

If a borrower disputes a lender's determination, the borrower and lender may jointly submit a review request to the Director of FEMA during the 45-day period after the borrower is notified that flood insurance is required. Requests submitted more than 45 days after borrower notification will not be reviewed, will be returned with the fee, and should not be resubmitted.

FEMA will assess a flat fee to cover a majority of the costs associated with reviewing, recording, processing, and dis-patching FEMA determinations. The fee will also apply to a finding of insufficient information. Because the fee is not imposed or required by the lender, it is not required to be included in the finance charge pursuant to Regula-tion Z, 12 CFR, part 226. The lender and borrower must decide who will pay the fee. Payment must be by check or money order, payable to the National Flood Insurance Program.

The fee will be reviewed annually, and if changed, FEMA will publish a notice in the Federal Register.

Review requests should be mailed to the following locations:

- For Minnesota and locations east of the Mississippi River:

  Determination Review
  Coordinator
  c/o Dewberry & Davis
  P.O. Box 2020
  Merrifield, VA 22116-2020

- For Louisiana and locations west of the Mississippi River:

  Determination Review
  Coordinator
  c/o Michael Baker, Jr., Inc.
  Suite 600
  3601 Eisenhower Avenue,
  Alexandria, VA 22304-6439

The request for a determination review must be an original (not photocopied) and signed by at least one of the borrowers' legal representatives for the loan. The lender also must sign the request. To ensure the involvement of all appropriate parties, FEMA will *not* accept the signature of a third-party determinator as a representative for either the borrower or the lender. If both parties' signatures are not included in the request, the request will be returned without review. The requestor will be notified that the data submitted with the request does not meet the requirements of §65.17 of the regulations; there-fore, the lender's obligation to require the purchase of flood insurance remains in effect.

The law states that FEMA shall respond to review requests within 45 days on disputes arising out of loan originations. The 45-day time period begins on the day that the package is received by FEMA. Delay may be minimized if a request for review is submitted immediately after the borrower is notified by the lender that flood insurance is required, and if a complete data package is submitted to FEMA. Packages with insufficient information will be returned with the fee, and the parties will be advised of the information needed for the review to be accomplished. The borrower will have 14 days to resubmit the package with the fee or until the end of the original 45 days, whichever is longer. There is no additional charge.

A building found to be in an SFHA is required to have flood insurance coverage. However, if the Director of FEMA fails to respond to the review request before the later of 45 days after receipt or the closing of the loan, then there is no obligation for flood insurance coverage until the Director provides a determination. Apart from the law, it is industry practice for a lender to contractually require the prospective borrower to obtain flood insurance coverage as a condition of granting the loan. If FEMA subsequently determines that flood insurance coverage is not required, there is an NFIP procedure that allows cancellation with refund of premium for the current policy term.

(b) Supporting Materials

Under the determination review process, the parties must present technical information to the Director of FEMA for review. This information includes the completed SFHDF (see Appendix 6), copy of the lender's notification to the borrower, applicable FIRM or FHBM panel, and all other technical information used in making the flood zone determin-ation. A copy of the NFIP FIRM or FHBM used to make the determination should be provided, to assess whether the most current panel was used. The title block, including map date, scale bar, and north arrow, and the portion of the map including the property location (with that property location annotated) are the only portions of the FIRM or FHBM that must be provided. If the submitted data does not include all relevant information, FEMA will return the request for review.

The request must include the same technical data used by the lender or third-party flood zone determi-nation company to make the determination. Items to complete this requirement typically include:

- A copy of the tax assessor's map showing the property
- A property survey map show-ing the location of the building as related to the property
- A copy of the plat for the subdivision/tract or similar document
- Information showing the rela-tionship of the building and FIRM or FHBM.

Buildings located in rural areas, or areas where the FIRM or FHBM shows few physical features, may need additional reference data to definitively locate the property and the building on the property. For multiple-unit buildings, data must be submitted for all of the building(s) located within the same SFHA. Properties with multiple buildings must show data for all structures. A building porch or deck should be indicated in detail.

After reviewing the required supporting technical information, FEMA will issue a written determination—referred to as a Letter of Determination Review (LODR)—indicating its concur-rence or disagreement with the original determination made by the lender, and stating whether the FIRM or FHBM indicates the subject building or mobile home is in the SFHA.

(2) Administrative Review

In conducting the review to determine the accuracy of a map, FEMA will check its Community Information System database for LOMAs, LOMRs, and LOMR-Fs that would affect the determination. If the original determination overlooked a LOMA, LOMR, or LOMR-F, FEMA's final response will so state and will provide the date of the letter. LOMAs, LOMRs, and LOMR-Fs are available through the community's map repository.

In addition, the Director of FEMA will review contested determinations dealing with remapping, map revision, or a routine portfolio review. The law does not require the agency to respond to these inquiries within the 45-day time period.

Any determination that the building is not subject to the mandatory purchase requirement can be relied on until a new map becomes effective for the community. The statute states that a determination of the Director of FEMA shall be final.

2. Nonparticipating Communities and Restricted Coverage Areas

a. Regulated Lending Permitted

Conventional loans can be made in communities that are not participating in the NFIP. However, federally backed loans in nonparticipating communities may be made only in non-SFHAs.

The 1973 Act, which first introduced the mandatory purchase provision, totally prohibited federally related financing by private lending institutions, as well as the Small Business Administration (SBA), Department of Veterans Affairs (VA), and Federal Housing Administration (FHA) in nonparticipating areas. This law met with some resistance, which resulted in a further 1977 amendment deleting this prohibition for regulated lenders. The 1977 law substituted a notice requirement in lieu of the prohibition on lending. That notice appears as part of the Notice to Borrower form (Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance) (see B.2.c).

Consequently, lenders regulated by, or whose deposits are insured by, Federal entities for lending regulation may make conventional loans secured by mortgages on buildings and mobile homes in SFHAs in nonparticipating communities. They may do so notwithstanding the fact that such property is not eligible for the purchase of National Flood Insurance. Lenders are still required to observe the provisions of the Federal laws and regulations governing the NFIP related to making determinations and providing notice, even though the requirement to purchase flood coverage does not apply. However, because of the lack of NFIP coverage and limited Federal disaster assistance, lenders should carefully evaluate the financial risk involved in making such loans. In nonparticipating communities, a lender may require the borrower to have in place private flood insurance, if available.

In those communities where the availability of flood insurance is limited, the inability of the property owner to purchase NFIP coverage does not prevent a lender from making a conventional loan with respect to that structure. The statute mandates coverage only when "the sale of flood insurance has been made available," 42 U.S.C. §4012a(b). As stated in the Supplementary Information section of the final regulations, a lender may exercise discretion and decline to make a loan in an SFHA where Federal flood insurance is not available. Also, lenders with significant lending in nonparticipating communities should establish procedures to ensure that loans on buildings in SFHAs where flood insurance is not available do not constitute an unacceptably large portion of the institution's loan portfolio.

Although a conventional loan may be extended in a nonparticipating community, a lender may not be able to pass such a loan on to a regulated lending institution or to the secondary market. Some GSEs, such as Fannie Mae and Freddie Mac, have stated they will not buy mortgages secured by properties in nonparticipating communities if they are located in an SFHA. To ensure that such loans are not delivered to them, Fannie Mae and Freddie Mac now require lenders to monitor, on an ongoing basis, changes in a community's status under the NFIP.

b. Federal Financial Assistance and Disaster Assistance Limited

Section 42 U.S.C. 4106(a) addresses the responsibility of Federal officers and agencies dealing with Federal financial assistance in SFHAs in nonparticipating communities where flood insurance is not available. To prevent the Federal Government's financial exposure to potential loss from flood damage to uninsured buildings located in these areas, Federal officers and agencies are specifically prohibited from providing financial assistance for acquisition or construction purposes for use in SFHAs in nonparticipating communities.

Without eligibility for government- supported VA or FHA loans associated with the purchase of housing, the sale of homes is affected. Nonparticipating community residents and developers are ineligible to obtain direct Federal loans to build buildings within the floodplain. By virtue of the 1977 amendment to the 1973 Flood Disaster Protection Act, however, they remain eligible for conventional loans from federally insured banks.

The 1994 Reform Act limits Federal disaster assistance in participating as well as non-participating communities. Section 5154a(a) of Title 42, which is part of the Stafford Act, places limits on disaster assistance benefits. The law precludes certain Federal disaster assistance related to repair of buildings, including loan assistance payments, if previously received flood disaster assistance was conditioned on carrying flood insurance and no policy is in effect.

c. Notification of the Unavailability of Disaster Assistance

The 1977 amendment to the 1973 Act created a notice requirement under which a regulated lender, when lending on a secured improved real estate loan in a nonparticipating community, must notify the borrower of the unavailability of disaster relief assistance in the event of a disaster caused by flood. The notice requirement does not apply to unsecured loans, or to loans secured by buildings that are not located in an SFHA. While the 1977 amendment removed the prohibition against making conventional loans in nonparticipating communities, the "notice" provision, found at §4106(b) of the 1994 Reform Act (see Appendix 4), requires affected lenders to notify borrowers whether Federal disaster relief will be available for the building. For the convenience of lenders, FEMA has incorporated that notification into the lender notice form.

d. Buildings Ineligible for NFIP Coverage

(1) Underwriting Restrictions

Some policy provisions and underwriting rules pertaining to the Standard Flood Insurance Policy preclude certain properties or parts of a building from eligibility for coverage. For example, a building built completely over water cannot be insured under the Program if the building was newly constructed or substantially improved on or after October 1, 1982, nor can boathouses. The NFIP policies also contain restrictions on insurance coverage, such as the portions of finished basements and Post-FIRM elevated buildings where only enumerated and limited coverage is available. A complete and current list of coverages and exclusions may be found in Title 44 of the Code of Federal Regulations, Chapter I, Section 61.5, and the standard form of flood insurance policies issued under the NFIP, reproduced in Appendix A to Part 61 of the regulations.

Certain categories of properties, as described below, are located in participating communities, but flood insurance coverage is restricted. In these special situations, Congress or FEMA has chosen to deny eligibility for flood insurance, treating the buildings similarly to risks in nonparticipating communities.

(2) Coastal Barrier Resources Act

The Coastal Barrier Resources Act (CBRA), 16 U.S.C. Sec. 3501, was initially enacted by Congress in 1982 to reduce or restrict Federal Government actions that were believed to encourage development in certain undeveloped coastal barrier areas, including both islands and mainland property. While CBRA does not prevent private financing and development, it does limit financial assistance by Federal agencies on undeveloped coastal barriers, except for enumerated situations such as assistance for emergency actions essential to saving lives, protecting property, and preserving public health and safety. Any form of expenditure of federal funds for a loan, grant, guarantee, insurance payment, rebate, subsidy, or any other form of direct or indirect Federal assistance is prohibited. Such emergency assistance would not include disaster assistance and government loans.

CBRA, which also added §4028 to the 1968 Act, prohibits the NFIP from providing flood insurance protection for buildings built, or substantially improved, after the area has been designated as an undeveloped coastal barrier area.

Buildings already located in the designated areas and walled or roofed prior to the designation remain eligible for coverage. If a building built in a designated area prior to it being designated sustains substantial damage as a result of a fire, flood, hurricane, or other causes, the restored building is not eligible for flood insurance coverage.

Lenders are required to notify borrowers that the building is in an SFHA. However, the unavailability of flood insurance does not prevent the making of a conventional loan. As with loans in nonparticipating areas, lenders would be well advised to assess the flood risk in deciding whether to grant the loan.

(3) Buildings in Violation of State or Local Laws

In accordance with Section 1316 (42 U.S.C. 4023) of the 1968 Act, a conventional loan can be made when the building is located in an SFHA of a participating community, but is not eligible for flood insurance protection because it has been declared to be in violation of local floodplain management building codes. Nevertheless, compliance with the provision notifying the borrower that the building is in an SFHA would be especially important. Because of violations relating to protection against flooding, buildings that come under the provisions of Section 1316 usually will be highly susceptible to flood damages, and are a far greater risk to the lender than buildings compliant with floodplain management ordinances.

With respect to both CBRA and Section 1316 properties, the lack of available NFIP coverage in a participating community does not prohibit a lender from making a conventional loan. The statute mandates coverage only when "the sale of flood insurance has been made available," 42 U.S.C. §4012a(b).

C. GENERAL MANDATORY PURCHASE PROVISIONS

This section of the guidelines describes the entities regulated by the 1994 Reform Act_and specific provisions encompassed by the law. Reference is made to the statute and regulations as well as the practice of the insurance and lending industries in implementing the law.

1. Entities Encompassed by the Act

The 1994 Reform Act amended §4012a of 42 U.S.C. to address flood insurance purchase and compliance requirements and escrow accounts. The essential part of the compliance provision is contained in §4012a(b), which addresses three kinds of lenders:

- Federally regulated lenders
- Government-sponsored enterprises (GSEs)
- Federal agency lenders.

The new law focuses on compliance with the mandatory purchase requirement as the responsibility of federally regulated private lenders and GSEs that purchase loans in the secondary market. These entities must ensure that a building or mobile home and any applicable personal property securing a loan are covered by flood insurance for the term of the loan. The amount of flood insurance must be at least equal to the outstanding principal balance of the loan or the maximum amount of coverage made available under the 1994 Reform Act for the particular type of property, whichever is less.

While the 1973 Act only required the purchase of flood coverage, the 1994 Reform Act clearly specifies that flood insurance is required for the term of the loan, or any time during the term of the loan when the lending institution determines that the building or mobile home is located in an SFHA.

Section 4012a(b) subdivides its treatment of the entities regulated, yet imposes similar requirements on the three types of affected lenders. Essentially, the statute mandates flood insurance coverage even if the SFHA designation is first identified after settlement, but during the term of the loan, because of remapping or other reasons.

The 1994 Reform Act's main impact is on residential mortgage lenders and loan servicers; yet, whether the loan is for consumer or commercial purposes is irrelevant. The extension of credit may take several forms, including loan, refinancing, consolidation, or renewal of an existing extension of credit. The mandatory purchase requirement attaches to any type of secured loan, whether a fixed rate, variable rate, or balloon loan. The requirement to obtain flood insurance also applies regardless of the type of security interest taken (e.g., a mortgage indenture, judgment note, cognovit note, or any other type of security or trust agreement). The mandatory purchase provisions apply even on those loans where real estate is secured out of "an abundance of caution."

As stated in the Supplementary Information section of the final regulation, the duties of a regulated lender with respect to Federal flood insurance requirements for a particular loan cease upon the sale of the loan. An exception would be if the seller of a loan agrees to retain responsibility for complying with the 1994 Reform Act's requirements under a loan-servicing agreement with the transferee. For example, if a regulated lender sells the loan to an unregulated lender while retaining servicing rights, it will also retain obligations under the service contract.

Most of the provisions of the 1994 Reform Act became effective on September 23, 1994, and apply prospectively to all new loans and regulated activity, but not to existing loans for which no changes have occurred since that time. Review of existing loans is encouraged, but not required, by the 1994 Reform Act.

The following entities are *not* covered by the 1994 Reform Act:

- Unregulated private financial institutions that engage primarily in the purchase of mortgage loans
- Unregulated mortgage bankers or brokers who only serve as loan originators
- Private mortgage lenders
- State regulated lending institutions not tied to Federal oversight.

a. Federally Regulated Lenders

The most significant mandatory purchase provision is found in Title 42 U.S.C. 4012a(b)(1). That subsection directs Federal regulators to adopt regulations requiring the lenders subject to their jurisdiction to compel borrowers to purchase flood insurance protecting any "improved real estate or mobile home" located in an SFHA, if the building, mobile home, and any applicable personal property securing such loan is to be the security for the loan. This provision is the crux of the law, around which the other requirements of the 1994 Reform Act have been structured.

The flood insurance provisions of the 1994 Reform Act require the following Federal agencies to revise their current flood insurance regulations to reflect the changes in the law:

- Board of Governors of the Federal Reserve Board
- Office of the Comptroller of the Currency (OCC)
- Office of Thrift Supervision (OTS)
- Federal Deposit Insurance Corporation (FDIC) (All State FDIC member banks, including small institutions, are subject to the amended provisions.)
- National Credit Union Administration (NCUA)
- Farm Credit Administration (FCA).

These six Federal entities for lending regulation have issued a joint regulation to fulfill the statutory requirements. All six agencies coordinated and consulted with the Federal Financial Institutions Examination Council (FFIEC) in developing this joint regulation. The final regulation was published in the Federal Register on August 29, 1996, and appears in each agency's regulations. Citations to the various CFR sections can be found in Appendix 1.

The institutions supervised by the six agencies are referred to collectively as regulated lending institutions or lenders, 42 U.S.C. §4003(a). These lenders include any bank, savings and loan association, credit union, Farm Credit System Institution, or similar institution that is supervised, regulated, or insured by a Federal entity for lending regulation.

A significant change of position by the agencies is their interpretation of the 1994 Reform Act's new definition of "regulated lending institution" to include subsidiaries of institutions that are service corporations. This definition includes the phrase, "similar institution subject to the supervision of a Federal entity for lending regulation," as defined in §4003(a)(10). The agencies apply their flood insurance regulations to service corporations that engage in mortgage lending, believing that this position is consistent with the 1994 Reform Act's statutory language and Congressional intent. This practice also ensures uniform and consistent treatment for "regulated" financial institutions.

Federal lending regulators deem subsidiaries of the institutions they regulate as subject to the rules applicable to the operations of the parent. Therefore, although a subsidiary entity that engages in mortgage brokering or servicing may not be directly regulated, it is considered subject to the mandates of the 1994 Reform Act. As noted in the Supplementary Information section of the final regulations, the agencies believe that the purpose of the Federal flood insurance statutes is best served by treating loans made by a subsidiary service corporation in the same way as a loan made by others in the corporate structure. For example, the FDIC's portion of the joint final rule makes subsidiaries of insured nonmember banks subject to Federal flood insurance requirements by defining the term "bank" to include a subsidiary of such institutions. The Reform Act included this provision to increase compliance with the mandatory purchase requirements among regulated lenders.

The 1994 Reform Act requires the applicable Federal regulator to develop regulations that direct regulated institutions not to make, increase, extend, or renew any loan on a building located in an SFHA unless flood insurance is purchased and maintained for the term of the loan. The Conference Committee report accompanying the Act confirms that refinancing an existing loan is to be considered as the making of a new loan for purposes of the mandatory flood insurance purchase requirements.

b. Government-Sponsored Enterprises

Government-Sponsored Enterprises for Housing (GSEs) include the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Government National Mortgage Association (Ginnie Mae). These entities are privately owned, federally chartered corporations whose sole business is to support residential housing by providing a secondary market for mortgages. They are required under the new §4012a(b)(3) to implement procedures reasonably designed to ensure that designated loans have flood insurance at the time of origination and at any time during the term of the loan.

The variation in the compliance wording from that found in the regulated lender provision can be attributed to the fact that GSEs have a contractual, not a regulatory, relationship with their sellers. The GSE requirements are imposed upon the primary lender as a condition of purchasing the loan. Thus, borrowers not directly covered by the mandatory purchase law will ultimately be required to satisfy the statutory flood insurance requirements if their lenders sell their loans to Fannie Mae or Freddie Mac. The mandatory purchase requirements flow from the original transaction.

Also, under the guidelines of Fannie Mae and Freddie Mac, servicers of loans sold to those agencies are required to assume responsibility for compliance with the flood insurance requirements. However, no existing flood insurance requirements cover lenders or servicers that are not federally regulated and that do not sell loans to Fannie Mae, Freddie Mac, or other GSEs.

As secondary market agencies, GSEs have no direct contact or dealings with borrowers, but do have the ultimate exposure on the loan. Consequently, the GSE guidelines are designed to ensure that any "covered loan" they buy has flood insurance for the life of the loan. Freddie Mac and Fannie Mae now require lenders and servicers to keep flood insurance up to date, monitor publication of all future map and community changes, and impose or relieve the mandatory purchase requirement during the term of the loan.

The GSEs have the ability to establish their own requirements to protect their interest in the loans they purchase. These standards can be more stringent than those found under the Federal regulations. For example, although the Federal regulators do not require monitoring for map changes, the GSEs do, thereby providing the impetus for monitoring. See Appendix 7 for GSE-issued guides (excluding community listings).

c. Federal Agency Lenders

The statute in §4012a(b)(2) gives a new name to this category of lender, known as the "Federal agency lender." The law now broadens the flood insurance requirement to specifically include loans on applicable real estate secured by Federal agencies. Federal agency lenders such as the FHA, the SBA, and the VA may not subsidize, insure, or guarantee any loan if the building securing the loan is in an SFHA of a community not participating in the NFIP. For the most part, Federal agency lenders follow the same standards set by the Federal regulators, although some exceptions can be found.

2. Specific Provisions of the Act

a. Limits Available

The 1994 Reform Act §4013(b) increased the maximum amounts of flood insurance available under the NFIP.

The current amounts are shown below:

Building Coverage	**Emergency Program**	**Regular Program**
Single-family Dwelling	$ 35,000	$250,000
2-4 family dwelling	$ 35,000	$250,000
Other residential	$100,000	$250,000
Nonresidential	$100,000	$500,000
Contents Coverage		
Residential	$ 10,000	$100,000
Nonresidential	$100,000	$500,000

Special limits apply in Alaska, Hawaii, Guam, and the Virgin Islands. See page RATE 1 in the NFIP *Flood Insurance Manual* for details.

The current maximum limit of coverage for residential properties is $250,000 for building and $100,000 for contents; and for nonresidential properties, $500,000 for building and $500,000 for contents. Whenever FIA changes the amounts of coverage available or amends the policy form, the change is published in the Federal Register.

(1) Land Not Insurable

The Reform Act applies to improved real estate, i.e., buildings, not land. Section 4012a(b) describes the flood insurance purchase requirement for lenders making conventional loans in terms of "improved real estate or a mobile home located or to be located" in an SFHA. The law conditions the making of a loan in an SFHA upon there being flood insurance covering "the building or mobile home and any personal property securing such loan." The building must be insurable under NFIP requirements in order to qualify for an NFIP policy.

The reference to "buildings and mobile homes" is consistent with the NFIP's practice to insure only buildings, including manufactured homes (mobile homes), and not raw land. Thus, improved real estate, as used in §4012a(b) of the 1994 Reform Act, means land with a building on it. The mandatory flood insurance purchase requirement applies only to the buildings and manufactured homes that constitute the improvements on the land. Inasmuch as the NFIP does not provide insurance coverage for land, only for buildings, the location of a building in relation to the SFHA determines the applicability of the mandatory purchase provisions. Some portion of the building itself, and not just a portion or portions of the land, must be located in an SFHA for the mandatory purchase provisions to apply. Buildings located within the Flood Insurance Rate Map (FIRM) area, but not within the SFHA, are insurable in participating communities.

(2) Calculating Coverage

The NFIP policy does not provide coverage for losses to unimproved real estate, i.e., raw land. The lending regulations provide that, in addition to the statutorily prescribed dollar limits, flood insurance coverage under the NFIP is limited to the overall value of the building. Accordingly, a lender must evaluate the amount of coverage required in relation to the portion of the loan that is associated with the improved real estate (excluding the appraised value of the land), or the maximum amount of insurance available under the NFIP, whichever is less. This is especially significant in cases where the loan exceeds the value of the insurable building(s). Where the outstanding principal balance of the loan exceeds the value of the building, the lender should exclude the value of the land in determining the amount of coverage needed. When the lender does not take into account separate valuations of land, which is not insurable under the NFIP, and improvements, which are insurable, the insured may be paying for coverage that exceeds the amount the NFIP will pay in the event of a loss. Lenders should avoid creating such a situation.

Lenders should follow the same general business practice in calculating the flood insurance coverage amount on a building as they do in placing hazard coverage. The terms and conditions of the hazard clause contained in the loan document fully describe the rights and conditions of the parties.

In addition, in determining the amount of insurance to carry, lenders must consider the extent of recovery allowed under the NFIP policy forms, as described below:

- General Property Policy Form
  - Designed for use on nonresidential risks
  - Limits recovery to actual cash value; coverage is intended to include repair or replacement less depreciation.

- Dwelling Policy Form
  - Designed for use on residential risks
  - Pays losses on the basis of replacement value for primary residences where the insured has purchased insurance of up to at least 80 percent of the replacement cost of the building. Under the NFIP policy, "replacement value" means that the coverage is intended to include the full cost of repair or replacement without deduction for depreciation.
  - Pays losses on the basis of actual cash value for secondary resi-dences and commercial buildings

- Residential Condominium Building Association Policy Form
  - Described in Section D
  - Has its own replacement cost provision.

NFIP policies now include Increased Cost of Compliance (ICC) coverage for the increased cost to rebuild, or otherwise alter, a flood-damaged property to bring it into conformance with state or local floodplain management laws. ICC coverage should not be considered as a factor in determining the amount of flood insurance required.

(3) Deductible

The amount of the deductible is set by FEMA/FIA in the regulations. As of May 1998, the standard minimum deductible for policies rated on the basis of subsidized rates is $1,000. A minimum $500 deductible applies to all other policies. The maximum deductible is $5,000. NFIP makes available optional deductibles higher than the standard $500 and $1,000 deductibles at a premium discount. Policyholders who wish to reduce their standard $1,000 deductibles may opt to purchase separate $500_deductibles for building and contents coverages, for an additional premium.

It is the practice in the financial industry for the lender to dictate the amount of the deductible based upon the authority found in the loan document hazard clause. A modification in the deductible can be accomplished at renewal or by endorsement mid-term with the lender's written request.

Neither the 1973 Act nor the lender regulations address the amount of deductible that must be carried. However, lenders often exercise their business judgment prerogative by requiring that only the standard deductible be carried as a safeguard in protecting their interest in the improved real estate. The GSE secondary-market members designate what they consider as the proper deductible. Freddie Mac's guide states the deductible may not exceed the higher of $1,000 or 1 percent of the policy's insurance limits, subject to the maximum deductible allowed under the NFIP. Fannie Mae's guide provides that unless a higher maximum deductible amount is required by state law, the maximum allowable deductible is the higher of $1,000 or 1 percent of the face amount of the policy.

(4) No Coverage if Land Loan Only

If a lender makes a loan in which there is no lien on any land upon which there is a building, i.e., improved real property, the flood insurance purchase requirement does not apply. The NFIP does not insure land, and the 1994 Reform Act does not address mortgages secured by land alone. Similarly, if the purpose of a loan transaction is to facilitate the purchase of land for subsequent development, and any improvement on the real property is of nominal value, the wording of the mortgage must specifically exclude the building as part of the security for the loan in order to avoid the mandatory purchase requirement. This is consistent with the purposes for which the purchase requirements of the 1994 Reform Act were adopted: to protect lenders and Federal resources against potential losses resulting from uninsured secured loans, and to protect unwary borrowers against financial losses resulting from losses to uninsured buildings.

(5) Low-Value Building on High-Value Land

Lenders are sometimes confronted with a situation where a building is being used for residential or commercial purposes on land whose value alone would be sufficient to secure the loan without regard to the value of the building. In this situation, the 1994 Reform Act does not give a lender the option of enabling the borrower to avoid the purchase of flood insurance, even though the value of the land would provide more than adequate security for the amount of the loan, without taking into account the value of the building on the land. If the land has a building on it, and the lender has a security interest in that building, the lender must require the purchase of flood insurance to protect its security interest. The insurable value of the building and its improvement(s) will govern the amount that can be required. The amount of required flood insurance coverage is the lesser of the principal balance of the loan(s) or the maximum coverage available under the NFIP. The NFIP policy does not provide coverage for losses in excess of the value of the insurable building. By carrying coverage, the lender also is protecting the Federal Government's interests by preserving the assets of agencies that insure the lender's deposits.

The question of limits on high-value land with relatively low-value buildings can be an issue in agricultural lending. The regulators have made clear that Congress, in enacting the 1994 Reform Act, did not differentiate agriculture from other types of lending, and no exception by regulated lenders can be made without legislative action.

The value of the land should be deducted from the overall value of the secured property when calculating the required limits.

(6) Buildings in the Course of Construction

When a structure is to be built in an SFHA that, when completed, will be a walled and roofed building that will be eligible for coverage, flood insurance must be purchased to provide coverage during the construction period. Therefore, when a development or interim loan is made to construct insurable improve-ments on land, flood insurance coverage must be purchased. The only practical way of implementing the flood insurance coverage is to require the purchase of the policy at the time that the development loan is made, to become effective at the time the construction phase is commenced, and in an amount to meet the mandatory purchase requirement.

Material to be used on a building in the course of construction, but yet to be walled and roofed, is eligible for flood insurance, subject to certain underwriting restrictions. The NFIP, to the extent possible, conforms its practices with those of fire insurers by providing insurance coverage that begins during the period of time when construction is taking place.

For new construction in Regular Program communities, the Elevation Certificate_and the premium will be based on an elevation figure derived from construction drawings. However, the policy will not be renewed until a new Elevation Certificate, based on actual construction, has been submitted. Coverage under the policy becomes available immediately when the construction starts, and is not delayed until the building has reached a roofed and walled condition.

(7) Mobile Homes

The statute brings within its scope a loan securing mobile homes that are, or will be, located in an SFHA. The loan need not include security in the real estate underlying the mobile home in order for the mandatory purchase provisions to apply. NFIP coverage is available only with respect to a building or mobile home and not the land on which the building or mobile home sits. A chattel mortgage on a mobile home will trigger the mandatory purchase requirements.

The lending regulations and FEMA/FIA use the term “manufactured home” interchangeably with “mobile home.” FEMA has defined this term in its regulations. See 44 CFR 59.1 (defining manufactured home), 44 CFR 61.13, and Appendix A to 44 CFR part 61 (FEMA's standard insurance policy defining mobile home as meaning manufactured home). To be eligible for coverage in an SFHA, a manufactured home must be on a permanent foundation and meet specific anchoring requirements. A manufactured home does not include a recreational vehicle.

The supplementary information that accompanies the regulations acknowl-edges that in some situations a lender may not know where the manufactured/ mobile home will be located until just prior to the time of loan closing. The agencies will not apply the borrower notice requirements to those "home only" mobile home transactions that close before the permanent location for the mobile home is known. Clearly, a lender cannot determine whether flood insurance is required before the location of the mobile home has been fixed. Upon learning the location of the mobile home, the lender must use its best efforts to determine whether the mobile home is in an SFHA, notify the borrower, and mandate the purchase of any required flood insurance.

Although the Real Estate Settlement Procedures Act (RESPA) does not require escrowing on a loan where land is not part of the security, the scope of the 1994 Reform Act includes escrowing on a designated loan secured by a mobile home. Section 10 of RESPA, which pertains to the escrow rules, only applies to mobile homes that are also secured by the real estate upon which they are situated; however, the 1994 Reform Act is broader in scope. A mobile home lender is required to escrow even if the loan is on the mobile home only.

A substantial number of mobile homes have the peril of flood included under a private contract of insurance. A lender should review the private flood insurance coverage in light of the mandatory purchase and FIA guidelines (see Section E.5 of these guidelines).

(8) Personal Property

As specified in §4012a(b)(1) of the 1994 Reform Act, contents coverage is not required unless personal property, in addition to a building, secures the loan. Since residential mortgages rarely include personal possessions as part of the loan security, lenders are not required to compel borrowers to purchase contents coverage. When a commercial loan on a building includes inventory and other trade or business movable property as security for a loan, that property must be covered by flood insurance under contents coverage. On the other hand, flood insurance is not required for a loan financing inventory where the secured collateral is stored in a building located in an SFHA and the building is not security for the loan. Lenders are encouraged to advise borrowers to include contents coverage for personal property and inventory when it is prudent to do so.

b. Underinsured Buildings

The 1994 Reform Act repealed Title 42 U.S.C. §4013(b)(6), which contained a statutory limit for coverage required to be purchased. The Act requires coverage that is "in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available . . . ." The maximum amounts available are described in Section C.2.a above. Loans that previously had principal balances at the program limits may be found to be underinsured because of the new cap on limits. Lenders and servicers may adjust coverage limits at policy renewal.

To address the underinsurance deficiency, §4012a(e) of the 1994 Reform Act specifies a lender's notification and placement requirements for a building covered by less flood insurance than required by the Act. The statute designates the same steps to be followed in the event additional insurance is required as when no insurance exists. When a lender (or a servicer acting on the lender's behalf) discovers that a building used as security is not covered by an adequate amount of flood insurance, it must first provide notice and opportunity for the borrower to obtain the necessary amount of flood insurance. The lender then must purchase flood insurance in the appropriate amount on the borrower's behalf if the borrower fails to purchase it.

c. Home Equity and Second Mortgages

Flood insurance is required on designated home equity or second mortgage loans made by regulated lenders if the loans are secured by a building or a mobile home, regardless of the lien priority. Lenders also need to be cognizant that GSEs have specific provisions in their sales guides that mandate flood insurance on designated home equity and secondary mortgages. The location of the secured property, not the use of funds received on a home equity or second mortgage, governs whether flood coverage is required.

Even though home equity and second mortgage loans are subordinate to a primary loan, the terms of the mandatory purchase law apply with equal force. No matter what priority its loan may be, a lender remains subject to the various provisions of the Act, including the notification, Standard Flood Hazard Determination Form, and force placement requirements. However, as described in the waiting period section, the 30-day delay in effective date has been deemed by FIA not to apply on home equity loans and second mortgages. Coverage may go into effect without a waiting period.

Subject to the limit on insurance available and the requirement cap, a home equity lender must protect its interests by having coverage in place at the time the loan is extended. The lender must make a determination about the flood insurance requirement when the application for the loan is made. If the first mortgagee otherwise complied with the mandatory purchase requirements and no remapping has occurred, then no new determination is needed for the second mortgage or home equity loan. Drawing against an approved line of credit does not require further determinations to be made.

For loans with approved lines of credit to be used in the future, it may be difficult to calculate the amount of insurance for the loan because the borrower will be drawing down differing amounts on the line of credit 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. For administrative convenience in ensuring compliance with the requirements, a lender may take the following alternative approaches:

- Review its records periodically (at least annually) 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.

If a secondary lienholder determines a first mortgagee has neglected to obtain flood insurance coverage, it must be assured that coverage is purchased on the entire outstanding loan amount in order to comply with the 1994 Reform Act as well as to protect its priority as to insurance proceeds. Similarly, if the first mortgage has insufficient coverage, the borrower must cure this deficiency by purchasing additional coverage sufficient to protect all outstanding loans. Apart from the provisions of the 1973 Act, the lender can rely on the hazard clause of the home equity or second mortgage loan document in requiring coverage in any underinsured situation.

Since only one NFIP policy can be issued on a building, no matter how many loans exist, a secondary lienholder must verify that any required escrow of premium is being undertaken by the primary lienholder (see the escrow discussion at Section C.2.g). Accordingly, the lienholder must coordinate coverage through its borrower and the insurance agent of record. A home equity and secondary lienholder's interest is accomplished by endorsement to the policy.

Evidence of coverage can be confirmed by receipt of an insurance certificate from the agent or a revised declarations page from the insurer. A secondary lienholder should ensure its interest is protected by having its name appear on the policy or by other appropriate means. If the existence of a home equity loan or a second mortgagee is not made known to the insurer, appropriate renewal notices may not be sent.

The small loan exception of the 1994 Reform Act only applies if the original principal balance is $5,000 or less, and under a repayment term of 1 year. These criteria normally do not apply to home equity loans.

d. Notification Requirements

Under the 1994 Reform Act, all regulated lenders and Federal agency lenders must provide the following notices:

- Notification to Borrower, otherwise known as "Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance"
- Notification of Change of Servicer.

In addition, the lender should receive an Expiration Notice from the insurer. These notices are discussed below in the order presented (also see Appendix 4).

A lender also must complete the Standard Flood Hazard Determination Form (SFHDF) (see Appendix 6) prior to concluding loan processing.

(1) Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance

Lenders must continue to notify only those prospective borrowers whose loans secure a building located in an SFHA. The purpose of the notice is to advise the borrower about the Federal flood insurance coverage requirements and whether Federal disaster relief assistance is available in that location. In the case of multiple applicants on a single loan, each applicant should receive the notice.

The notice can be accomplished using the sample form attached to these guidelines as Appendix 4. The notice form can also be found as an appendix following the text of each agency's regulations. Use of the sample form is not mandatory. A lender will be considered to be in compliance with the notice requirement if the sample form is used, or if the required language of the form is used in another format. A lender may personalize and change the format of the sample form, but must provide the borrower with the minimum information contained in the regulations.

The notice must be provided a reasonable time before completion of the loan transaction to ensure that a flood insurance determination is made as a condition of a loan being closed. The regulations do not establish a fixed time period in which a lender must provide the notice. Instead, they state that what constitutes a reasonable time will necessarily vary according to the circumstances of the particular transaction. The agencies consider the giving of the notice 10 days prior to completion of the transaction as a reasonable time interval. Completion and delivery of the notice within this time period serves both to inform the borrower and to protect the lender.

In lieu of giving direct notice, the law provides that a financial institution may obtain "adequate assurances" in writing, from the "seller or lessor" of the property, that the borrower has been advised of all required information by the lender prior to settlement. The burden of determining the flood status of the property and providing notification remains with the lender, whether the notice is handled directly by the lender or through others.

The regulations track the 1994 Reform Act by also requiring a lender to extend this notification to any servicer of the loan. A lender must notify the servicer as promptly as possible after notifying the borrower, and in any event not later than the time that loan data such as hazard insurance and tax information is transmitted to the servicer. The notice may be provided in the same form as the notice to the borrower. This provision applies even if the servicer is affiliated with the lender.

The text of the Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance must include the following:

- A general warning with respect to the chance of flooding
- A description of the mandatory purchase requirements
- An explanation of the eligibility requirements to receive disaster relief
- A discussion of the availability of flood coverage through:
  - An insurance agent from the Direct NFIP (NFIP Servicing Agent)
  - A WYO insurer
  - A private flood insurer.

The form also references the review or appeal process through which a disputed flood hazard determination may be jointly submitted to FEMA for a final determination on whether a building or mobile home is located in an identified SFHA. The appeal process is explained more fully in Section B.1.e.

Because the form is also used by lenders for loans in nonparticipating com-munities, as required by §4106(b), it is also designed to advise borrowers whose property is located in an SFHA in those communities where NFIP flood insurance is unavailable. As stated earlier, a lender may choose to make a conventional loan in an SFHA in a nonparticipating community. However, government-guaranteed or insured loans (e.g., SBA, VA, and FHA loans) are not permitted to be made in those communities.

The notice required by this provision is different from the Uniform Residential Appraisal Report form, which contains questions on the location of a building relative to the SFHA. The appraisal report form is used by many lenders and Federal entities, such as Fannie Mae, Freddie Mac, HUD, and VA.

The regulations require the lender to retain a record or evidence of the borrower's receipt of the notice throughout the period the lender owns the loan. This record can be the borrower's statement or initials that the notice was received directly, or the U.S. Postal Service return receipt in either hard copy or electronic format. The lender need not retain a hard copy version of the notice to the borrower and loan servicer.

The applicability of this notice require-ment to mobile homes is discussed in Section C.2.a(7) of these guidelines.

(2) Notification of Change of Servicer

The 1994 Reform Act in §4104a(b) mandates that, if the secured property is in an SFHA, a regulated lender must notify the Director of FEMA or the Director's designee of the identity of the loan servicer when a loan is made, increased, extended, renewed, sold, or transferred. FEMA has designated the various WYO insurers, or the NFIP's Servicing Agent, as its representatives to receive the notice regarding change of servicer.

When a policy is first written, the agent fulfills the notice requirement by indicating on the policy application the name of the mortgagee who is to receive notices. The obligation on the part of the seller of the loan to inform FEMA's designee is also triggered each time the loan is assigned or transferred to another lender or servicer. The notice is to be sent to either the WYO insurer (directly or through the agent of record) or to the NFIP Servicing Agent if that entity is the insurer.

This notice requirement may be accomplished by utilizing whatever electronic or hard copy format the parties generally use. The regulators acknowl-edge the use of the RESPA Notice of Transfer of Servicing form, designed to advise a borrower of the replacing servicer's identity, as sufficient to meet this requirement if it contains all relevant information.

The information needed by FEMA or its designee includes:

- Borrower's name
- Flood insurance policy number
- Property address (including city and state)
- Name of lender or servicer making notification
- Name and address of new servicer
- Name and telephone number of contact person at new servicer.

The notification of the identity of the servicer is in the nature of a "general change endorsement," which is completed and submitted to the WYO insurer or NFIP Servicing Agent by the insurance agent of record.

The law requires this notification to be sent by the incumbent lender or servicer to the Director's designee not later than 60 days after the effective date of such change. This duty to notify is, in turn, passed along to the new (transferee) regulated lender or servicer upon subsequent change of servicer.

This notice procedure accomplishes several objectives:

- It makes the insurer aware of the identity of the party designated to receive mailings such as the expiration and policy renewal premium notice, which the 1994 Reform Act now requires the insurer to mail 45 days prior to the anniversary date.
- It eliminates any failure on the part of subsequent lenders or servicers to notify the insurance agent or insurer of a change in a mortgagee (or servicer) in order to enable renewal and/or expiration notices to be sent to the proper lender or servicer of the loan.
- This new requirement is designed to combat the high nonrenewal rate that occurs after the first year of the loan. For example, in the case where the insurance payments are not escrowed, without the updated information the mortgagee or servicer would have no way of verifying whether the borrower continued to renew the policy or allowed it to lapse.

The regulations make no provisions as to recordkeeping of the change of servicer form; however, the lender and servicer have the burden to demonstrate the notice was given.

If one institution acquires or merges with another, the successor institution must provide notice for the loans being serviced by the disappearing institution if the disappearing institution did not provide notice prior to the effective date of the acquisition or merger.

Although the statute requires the Director of FEMA or the Director's designee to be notified when servicing is transferred, neither the statute nor the regulations require notice when a loan is paid off.

(3) Expiration Notice

The Reform Act (42 U.S.C. 4104a (c)) and the SFIP both require the Director of FEMA (regarding direct business) and the Director's designee (i.e., a WYO carrier on WYO policies) to send a notice of the date of expiration of the policy contract. This expiration notice must be sent by first class mail to the insured, any known mortgagees, servicer, and the owner of the property. FEMA interprets the term "owner of the property" as used in the statute to mean the party insuring the risk. An expiration/reissue notice is also mailed to the insurance producer. The notice is to be sent not less than 45 days prior to expiration to the last known address of the recipients. The law does not require proof of receipt of the notice. The statutory notice provisions are in addition to any applicable terms and conditions found in the SFIP, as well as any obligation found in the mortgage or lending document between the debtor and creditor.

Under the provisions of the SFIP, the WYO insurer and the NFIP Servicing Agent also must notify the lender, or servicer acting on behalf of the lender, along with the borrower, when the insurance contract is due for renewal.

e. Standard Flood Hazard Determination Form

Independent of the notice requirements, a separate provision was added in the 1994 Reform Act, 42 U.S.C. §4104b, that now requires a lender to document a loan by entering information on the newly developed SFHDF. FEMA has developed a one-page standard form for recording the results of the determination of whether a building or mobile home is located in an SFHA. The authorizing regulation is found at 44 CFR §65.16, and the form is found in Appendix 6. The law requires the form to be used for all loans, not only those for which the building or mobile home is in an SFHA. The six agencies' joint final regulation requires their respective regulated lending institu-tions to use the SFHDF. In addition, the Fannie Mae and Freddie Mac Seller/Servicer Guides (see Appendix 7) also require use of the SFHDF.

Lenders will use the SFHDF to document the process of determining whether or not flood insurance should be required in connection with a given mortgage loan transaction, while Federal banking entities will use it to monitor compliance by lenders. The form will document that a determination was made for a building or mobile home, whether it is in or out of the SFHA, whether flood insurance is required, and whether Federal flood insurance is available.

(1) Determination Process

The lender can complete the form itself, or use an outside service to track and analyze the FIRM or FHBM. FEMA does not perform individual property flood hazard determinations. The lender must take the responsibility for making determinations, regardless of whether the lender actually makes the determination internally or acquires determination services from another source. The 1994 Reform Act (42 U.S.C. §4104b(d)) states that the lender may provide for the acquisition or determination of flood hazard information to be made by a person other than the lender only to the extent such person guarantees the accuracy of the information. Neither FEMA nor the lending regulators have designated standards for what constitutes an adequate guarantee of the information provided to justify reliance upon the data.

A previous determination may not be reused when making a new loan. If the loan is not new, i.e., if the transaction pertains to increasing, extending, renewing, or purchasing an existing loan, the determination can be reused if:

- It is less than 7 years old.
- No new or revised FIRM or FHBM has been issued in the interim.
- It was initially recorded on the SFHDF that became effective January 2, 1996.

The regulators will impose no regulatory penalty if the prior determination meets the above requirements. Once a new FIRM or FHBM has been issued, a lender must use the new map as a guide, and a new determination is required. Any disputes that arise between the lender and borrower concerning the location of a building in relation to an SFHA are eligible to be resolved in accordance with the review process as described in Section B.1.e.

If a borrower obtains a home equity or second mortgage from its first mortgagee that is secured by a secondary lien position, and provides evidence that adequate flood insurance coverage is in place for all loans, the lender can rely upon the original SFHDF if no remapping has occurred.

(2) Instructions for Using the SFHDF

The reverse side of the SFHDF has detailed, section-by-section instructions on its use. A separate SFHDF is required on loans on adjacent properties. However, if a single property contains multiple buildings, a listing of buildings on the parcel can be attached to the SFHDF. Only one building may be insured under one NFIP policy. Each building securing a loan must be covered by a separate NFIP policy.

The SFHDF may be used in a printed, computerized, or electronic manner and must be retained in either hard copy or electronic format. FEMA has addressed the required format of an electronically maintained form in its regulation. It is FEMA’s position that if an electronic format is used, the format and exact layout of the SFHDF are not required, but the fields and elements listed on the form are required. Any electronic format used by lenders must contain all mandatory fields indicated on the SFHDF.

The form need not be kept in the loan file, but a lender is expected to be able to retrieve the record within a reasonable time period upon being requested by its Federal supervisory agency. Lenders are neither required to provide nor prohibited from providing the WYO insurer, insurance agent, or the borrower with a copy of the form.

Lenders and servicers are reminded that the 1994 Reform Act gives them the responsibility of determining the flood zone location of each mortgaged building. They cannot discharge the duty simply by obtaining some form of self-certification or assurance from the mortgagor-borrower that the building is not in an SFHA. If the lender wishes to change its original determination of the building's location based on information submitted by the mortgagor, the lender/servicer must convince itself that its original determination was in error and make any change based on its review of that new information. A lender or servicer should not simply accept unsubstantiated allegations, from whatever source, about the building's flood zone location. The ultimate responsibility for making such determinations under the statute rests with the mortgagee, not the mortgagor. Contested determinations are subject to the review process described in Section B.1.e of these guidelines.

f. Waiting Period and Exceptions

The 1994 Reform Act modifies the waiting period required before an NFIP policy can go into effect from 5 days to 30 days. This 30-day wait is for "coverage under a new contract for flood insurance" and "any modification to coverage under an existing flood insurance contract." The express intent of Congress in mandating a 30-day waiting period was to prevent the purchase of flood insurance at times of imminent flood loss. Therefore, unless an exception applies, as described in the following two subsections, a 30-day waiting period applies.

(1) Coverage Obtained in Conjunction With a Loan

Exceptions to the 30-day waiting period apply when coverage is placed in conjunction with loan activity or the remapping of a community. The 1994 Reform Act (42 U.S.C. 4013(c)) contains what is called the "initial purchase" provision, which states the 30-day waiting period does not apply to the following instances:

- "The initial purchase of flood insurance . . . when the purchase is in connection with the making, increasing, extension, or renewal of a loan, " or

- "The initial purchase of flood insurance . . . pursuant to a [map] revision or updating of floodplain areas of flood zones" within a 1-year period.

The effective date of coverage is 12:01 a.m. (local time) on the first calendar day after the application date and the presentation of payment of the premium.

It is significant to note that the first exception described above to the 30-day waiting period (when the initial purchase of flood insurance is in connection with the making, increasing, extension, or renewal of a loan) is much broader than it appears. Pursuant to FIA Policy Issuance #5-98, effective October 1, 1998 (see Appendix 8), the FIA has interpreted the exception to the 30-day waiting period to apply in situations pertaining to refinancing, placement of second mortgages, and modification of existing mortgages. The Policy Issuance also applies to force placement, increased limits at renewal, and map revisions. For a detailed description of the waiting period rules, refer to the FIA Policy Issuance.

(2) Assignment of Policy

There is no waiting period when an existing policy is assigned to a purchaser of improved real estate.

Prior to the 1994 Reform Act, the regulations provided for no wait in the case of a title transfer, so long as the policy was applied for and the premium was paid at or prior to the time the title transfer or assignment of the policy occurred. Now, unless there is an assignment of the policy from the seller to the buyer where the purchaser does not obtain a mortgage, a 30-day wait is required by 42 U.S.C. §4013c(1).

The SFIP form contains an assignment provision in the General Conditions and Provisions Article, which allows an assignment upon transfer of title.

g. Escrow Requirements

The escrow requirement, Section 4012a(d), is limited to instances where a lender establishes an escrow account for a loan for another purpose. If financial institutions and their servicers require the escrow of taxes, insurance premiums, or any other fees or charges for covered loans, they must also escrow for premiums and fees for flood insurance.

(1) Real Estate Settlement Procedures Act

The mandatory purchase law expressly states that escrow accounts established under the 1973 Act are subject to the escrow account provisions of Section 10 of the Real Estate Settlement Procedures Act (RESPA) of 1974, which imposes accounting and notice obligations on a lender for consumer loans. However, in the Supplementary Information section of the final regulation, the agencies do address differences between the scope of coverage of the 1994 Reform Act and RESPA. They do not believe the 1994 Reform Act is intended to impose the particular requirements of Section 10 on loans that are not subject to RESPA generally, for example, commercial loans secured by residential buildings. The regulations note that nothing in the legislative history of the 1994 Reform Act suggests that Congress meant to extend the scope of Section 10 of RESPA in this way through the enactment of the 1994 Reform Act. Without specific direction from Congress, the agencies do not believe that they have the authority to expand RESPA's Section 10 coverage to loans that are not otherwise subject to RESPA.

RESPA, which generally limits the amount that may be maintained in escrow accounts, and requires notices containing escrow account statements for those accounts, applies primarily to escrow of consumer loans. Generally, this means that only loans on one- to four-family dwellings will be subject to the RESPA escrow rules. Loans on multi-family dwellings of more than five units are not covered by these requirements. However, even though they do not have to follow the RESPA escrow requirements con-tained in HUD’s Regulation X, 24 CFR 3500.17, lenders must escrow premiums and fees for any required flood insurance if the lender requires escrow for other purposes such as hazard insurance or taxes.

Therefore, other than for consumer mortgage loans, escrow accounts need not comply with the requirements of Section 10 of RESPA. As the preamble to the joint final rule points out, however, regulated lending institutions must comply with the escrow requirements contained in the 1994 Reform Act; it is the method of escrowing that may not be subject to Section 10 of RESPA.

Although the escrow provision only applies to residential loans, lenders are encouraged to escrow on all loans, including those on nonresidential improved real estate.

(2) Applicability

Unlike the RESPA escrow requirements, the escrow of flood insurance includes not only single-family buildings, but also multi-family properties containing five or more residential units. Consequently, escrow on certain residential real estate is required, even though the property may be secured under a commercial or business loan. The 1994 Reform Act's escrow provision applies to both home mortgage loans and commercial loans (including, for example, mortgages on apartment buildings or construction loans secured by residential buildings), but only if the lender requires the escrow of other charges for those loans. The mandatory purchase provisions make no distinction between single or multi-family dwellings or owner or renter occupancy. The lender is to consider the primary purpose of the building in making its determination. For example, if a building is a mixed-use property, i.e., part residential and part commercial, the primary purpose of the building controls.

Escrowing on all mobile home designated loans is required under the 1994 Reform Act, even though RESPA only requires escrowing if the loan encompasses the land upon which the home is situated.

The 1994 Reform Act's escrow provisions apply to financial institutions and their servicers, but do not apply to mortgage company originators over whom a Federal regulator has no jurisdiction.

Regulators will examine the loan practices of the lender to determine if the escrow is required. If a lender's loan practices indicate that escrow is normally required and the loan documents permit escrow accounts to be established, the regulators presume that an escrow account for flood insurance premiums also should be established in the event flood insurance is mandated. Various escrow-type accounts established for loans involving multi-family properties that are substantially different in purpose from single-family residences (e.g., interest reserve accounts and compensating balance accounts) do not constitute escrow accounts under the mandatory purchase requirements. If an escrow account is required, the law requires it to be set up "in a manner sufficient to make payment as due for the duration of the loan."

The flood escrow requirement facilitates the lender making payments as due for the life of the loan. In the past, a significant number of lenders did not require escrowing of flood insurance coverage; in those situations, NFIP coverage was susceptible to lapse. As stated in the committee report, the drafters of the law were mindful that a major reason for the lack of compliance with the NFIP was that many homeowners, believing they would not be flooded, simply stopped paying premiums on their flood insurance policies.

The new escrow practices are designed to balance the need to increase participation with the desire to prevent significant new burdens on lenders and borrowers. Requiring lenders to escrow for flood insurance premiums is expected to significantly improve participation in the NFIP.

(3) Escrow Exclusions

Not all accounts established in connection with a loan secured by residential buildings are considered to be escrow accounts that would trigger the requirement for the escrow of flood insurance premiums. The escrow provision for flood insurance would not be triggered in the following situations:

- Voluntary escrowing for credit life insurance
- Establishing accounts in connection with commercial loans for such items as interest or maintenance reserves or compensating balances. Generally, accounts established in connection with the underlying agreement between the buyer and seller, or that relate to the commercial venture itself rather than to the protection of the property, would not trigger the escrow requirements for flood insurance premiums.
- Voluntary escrowing for other expenses (escrow is not required, but established at the borrower's request)
- Lender termination of an escrow account for a loan.

h. Force Placement

(1) Authority

Similar to the requirements concerning the issuance of the various notices and escrow, the 1994 Reform Act places responsibility to force place on lenders as well as servicers. The Act requires the force placement of flood insurance if a servicer or lender determines that the building securing the loan is not adequately insured. The 1994 Reform Act also grants statutory authority to a lender or servicer to purchase flood insurance for the building and charge a premium to the borrower if the building is in an SFHA.

By enacting 42 U.S.C. §4012a(e)(2), Congress intended lenders to have clear authority to force place; under certain circumstances, they are obligated to force place. The force placement of coverage is designed for use at any time during the term of a loan in uninsured and under-insured situations; it is not intended for use at loan origination. If a borrower refuses to obtain flood coverage as a condition of obtaining a loan, the loan is deficient and is not to be made.

If at any time during the term of a covered loan, the lender or servicer determines that the building securing the loan is not covered by flood insurance, or is covered by such insurance in an amount less than that required by law, the lender or servicer must first notify the borrower of the need to carry adequate flood insurance coverage. The law does not specify the precise wording of this notice, so lenders and servicers should give a close reading to the statute and regulations for guidance. The notice must state that the borrower should, at the borrower's expense, obtain flood insurance that is not less than the amount required under the law.

If the borrower fails to purchase such flood insurance within 45 days after such notification, the lender or servicer shall purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees incurred by the lender or servicer. In an underinsured situation, when the borrower and the agent of record refuse to cooperate with the new lender, the loan should not be made. If the loan has already been extended, the lender should exercise recourse as provided under the terms of the loan document.

The 30-day waiting period enacted with the 1994 Reform Act does not apply to force-placed policies; instead, the 45-day period from time of notification that a lender must grant to a borrower to voluntarily obtain coverage is the only time delay that controls.

The 1994 Reform Act (42 U.S.C §4012a(f)(6)), contains preemption language stating that the NFIP force placement provisions prevail over state and local law. This wording is significant because many of the state laws that cover force placement are vague and open to interpretation. In addition, this subsection responds to those state laws that prohibit or limit the forced placement, or require the borrower's contractual agreement in order to force place coverage.

(2) Applicability

The terms of the force placement law are broader in scope than the escrow requirement. Force placement applies to any borrower of a designated loan, commercial or residential, whether or not escrow of expenses is required. On any type of force-placed policies, a lender should keep evidence of the determination of whether the loan is in an SFHA, including information concerning the map panel and method by which the determination was made.

Home equity and second mortgage loans also are included under the requirement. A secondary lienholder that force places coverage only to the extent of its loan will not protect its interest if a first mortgagee claims priority to any insurance proceeds. Force placement by a second mortgagee will require coordination with the first mortgagee, as well as with the insurance producer and insurer on the first mortgage, if one exists.

The 1994 Reform Act requires a designated loan to be covered for its term, in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage available. Although the 1994 Reform Act only requires the lender's interest to be protected by flood insurance, a lender may need to consider other factors, such as Fannie Mae and Freddie Mac requirements. Depending on the practice of the mortgagee, the policy may not be sufficient to protect the full equity amount held in the property by the mortgagor in the event of a loss. If the lender opts to protect only its security in the loan, the amount of the policy may be insufficient to cover the full insurable value of the building.

The 1994 Reform Act requires a lender to carry out the force placement as a matter of law, independent of the contractual provisions of the loan. Force placement is not limited to those situations provided for under the mandatory purchase law. Basic loan documents provided by Fannie Mae and Freddie Mac contain language that permit a lender or servicer to force place if necessary. The standard Fannie Mae and Freddie Mac documents permit the lender or servicer to add the force placement charges to the principal amount of the loan.

Force placement of flood insurance is intended only as a last resort, and on mortgages whose mortgagors have failed to respond to the notifications required by the law.

The 1994 Reform Act provides that a lender must inform its borrowers that they have a "free choice" of an insurer from whom to purchase coverage (§4104a(a)(3)(c)). That free-choice purchase option also applies to a lender when dealing with force-placed coverage. If, within 45 days from the notice, a borrower fails to comply by voluntarily obtaining coverage, a lender or servicer must either:

- Obtain an NFIP policy through a WYO insurer that participates in the Mortgage Portfolio Protection Program (MPPP), or
- Secure a Standard Flood Insurance Policy through either a WYO insurer or the NFIP Servicing Agent, or
- Obtain flood coverage from a private industry insurer if such coverage is available.

(3) MPPP Method of Placement

Most loans in which flood insurance is force placed must be processed with a limited amount of underwriting infor-mation. Therefore, placement is appropriate through the Mortgage Portfolio Protection Program (MPPP), where only limited underwriting infor-mation is required.

The MPPP is an optional program designed for lenders to force place flood insurance coverage under the NFIP with WYO insurers that have agreed to comply with the requirements of the MPPP. The Direct NFIP program does not offer the MPPP. The procedure for using the MPPP has been added to the regulations at 44 CFR §62.23 subsection (L). Other aspects of the MPPP can be found at Vol. 60, No. 167 of the Federal Register p. 44881 et. seq., a copy of which appears in Appendix 9.

The MPPP is an annual policy and, although it cannot be renewed, it can be rewritten each year if the required procedures are followed. The MPPP policy is rated based on the FIRM or FHBM in force at the time the policy is written. The rates allowed to be charged for force-placed policies are considerably higher than those rates available for voluntary policies because of the absence of any underwriting data. Under this program, the mortgagee obtains coverage for itself as well as the borrower; the NFIP insurance policy is a dual interest policy, whereby one contract covers both the borrower and the lender.

The NFIP *Flood Insurance Manual* should be consulted for additional information about using the MPPP to force place policies.

(4) Standard NFIP Policy

A lender also may force place flood insurance by purchasing a Standard Flood Insurance Policy (SFIP) from either a WYO insurer or the Direct NFIP program.

If a lender opts to obtain coverage under an SFIP, certain underwriting information must be available to the agent in order to place the policy. If adequate information is available, the rates used to calculate the premium will be the same as used on the SFIP rather than those used under the MPPP.

After the expiration of the 45-day waiting period, if the lender has sufficient information to produce a policy, it may place a policy with an insurer through an agent of its choice. This method of insuring the risk does not entail the use of any specific notice to the borrower.

(5) Private Flood Insurance

A lender has the option of force placing flood insurance through a private (non-WYO) insurer. Although very few carriers are generally willing to accept personal lines flood risks, some insurers will selectively write the coverage. If private insurance is available, the lender also must consider whether the policy, as well as the insurer, is acceptable to its regulator by meeting the criteria defined by the FIA. The FIA criteria are fully described in Section E.5 of these guidelines.

i. Exceptions

(1) State-Owned Property

If the security property is state-owned and covered by adequate policies of self-insurance, flood insurance is not required. FEMA maintains a list of states with adequate self-insurance programs. This exemption, by its terms, applies only to state-owned property, and not county- or city-owned property.

(2) Small Loan

Section 4012a(c)(2) provides an exemption from the mandatory purchase requirements for any loan made with an *original* outstanding principal balance of $5,000 or less, and with a repayment term of 1 year or less. The dual criteria must be met in order for this exemption to apply. There is no exemption for home equity or second mortgage loans unless they meet these exceptions.

D. CONDOMINIUMS, COOPERATIVES, AND TIMESHARES

The mandatory purchase requirements apply with equal force to condominium, cooperative, and timeshare units. Placing and monitoring coverage on units within a multi-unit building present special circumstances to lenders and merit particular treatment. Generally, the applicability of the mandatory purchase law can be explained through a review of how the various NFIP policies correspond to the forms of ownership of common interest community organizations, as follows:

- The Residential Condominium Building Association Policy (RCBAP) applies to all high-rise and low-rise residential condominium buildings and some timeshares in the Regular Program.
- The General Property Policy applies to cooperatives and some timeshares and condominium buildings not eligible for the RCBAP.
- The Dwelling Policy may be issued on an individual unit.

For eligibility requirements and limits available on the various coverages under these policies, refer to the Condominium section of the NFIP *Flood Insurance Manual.* Also, see Appendix 10 for the NFIP's Policy Issuance regarding this coverage.

1. Condominium Associations

Condominium association board members have a fiduciary responsibility to unit owners to protect the common property by assuring that appropriate insurance coverage is in place. This responsibility often includes providing adequate flood insurance to protect buildings located in

SFHAs. A residential condominium association may purchase NFIP insurance coverage on a residential building under the RCBAP. The premium for the policy is usually assessed as part of the unit owner's association dues. A condominium association may opt to purchase flood coverage under the RCBAP, even though individual owners may not have mortgages on their units.

a. Residential Condominium Building Association Policy (RCBAP)

The RCBAP is the policy specifically designed for condominium associations to insure residential condominium buildings. Under the RCBAP, the association is able to manage flood insurance needs and by-law requirements without relying on the actions of the unit owners. The valuation of the property subject to coverage is determined in accordance with Section C.2 of these guidelines.

The Federal mandatory purchase laws apply with equal force to condominium unit owners and their lenders, but the practice of the lending industry, as followed under the RCBAP, is to defer to the association to ensure compliance. A properly placed RCBAP is deemed to satisfy the Reform Act's escrow requirement. Although the association does not bear mortgage responsibility on the individual units, its interest springs from the obligation to maintain and repair the premises for the community benefit and unit owners as tenants in common. A key feature of the condominium insurance format is the separate ownership and mortgaging of individual units, yet the insuring of the building as a whole is with a policy issued to the association only. Because the RCBAP provides flood insurance coverage protection for both the unit and the common elements of common buildings, the security interests of individual unit owner mort-gagees should be protected, so long as coverage amounts reflect insurance to value, as with other forms of property insurance.

A unit owner's mortgage lender has no direct interest in an RCBAP and is not to be named an additional named insured.

(1) Evidence of Compliance

Upon the making, increasing, extending, or renewing of a loan on the unit and as frequently as required, a unit owner and the insurance agent should advise the unit's mortgagee of the RCBAP's existence to ensure that a mortgagee is aware that the mandated insurance requirement is being met.

The unit owner or the producer may provide the mortgagee evidence of the RCBAP by supplying a copy of the declarations page documenting the specific dollar amount of coverage. If a unit owner's mortgagee determines that the coverage purchased under the RCBAP is insufficient to meet the mandatory purchase requirements, it can request the borrower to ask the association to carry adequate limits, or require purchase of a separate unit owner's building coverage policy. The assessment coverage under the Dwelling Policy form will respond when there is no RCBAP, or when the building insured by the RCBAP is insured to 80 percent of the replacement cost and when a loss exceeds this amount.

(2) Coverage

Under an RCBAP, the entire building is covered under one policy, including both common and individually owned building elements within the unit, improvements within the unit, and personal property owned in common if contents coverage is carried. The RCBAP does not protect the individual owner from loss to personal property owned exclusively by the unit owner.

The NFIP prohibits duplication of NFIP policies on the same risk. As described below, both an association and a unit owner may obtain NFIP coverage, but the unit owner's coverage is proscribed in that it is in excess of the association policy. The RCBAP is primary in relation to the unit owner's policy.

(3) Policy Limits

The maximum amount of building coverage that can be purchased on a high-rise or low-rise condominium under the RCBAP is the replacement cost value of the building or the total number of units in the condominium building times $250,000, whichever is less. The maximum allowable contents coverage is the actual cash value of the commonly owned contents up to a maximum of $100,000 per building.

(4) Coinsurance Provision

The RCBAP encourages an association to purchase coverage in an amount equal to at least 80 percent of the replacement cost of the building or to the maximum amount of coverage available under the NFIP, in order to avoid the coinsurance penalty. If that threshold is met, the NFIP agrees to pay 100 percent of all compensable partial losses up to the limits of the policy minus any deductible. When an association carries limits to full replacement cost value, the unit owner does not need to obtain supplemental building coverage to cover a potential assessment in a total loss situation. The RCBAP's coinsurance provision requires a condominium association to carry NFIP coverage exclusively to comply with the insurance-to-value provisions.

Lenders must be aware of the coinsurance clause that applies if the association has not obtained appropriate coverage. To the extent the association has not purchased NFIP coverage in an amount equal to the lesser of 80 percent or more of the full replacement cost of the building at the time of loss, or the maximum amount of insurance available under the NFIP, the insured will not be reimbursed fully for a loss. Building coverage purchased under individual dwelling policies cannot be added to RCBAP coverage in order to realize the 80-percent requirement. The amount of loss in such a situation will be determined in accordance with the policy's coinsurance formula.

b. Dwelling Policy

A unit owner can acquire supplemental building coverage to the RCBAP by purchasing a unit policy under a Dwelling Policy form that is written in excess of the association policy. The policies are coordinated such that the Dwelling Policy purchased by the unit owner responds to shortfalls on building coverages pertaining either to improvements owned by the insured or to assessments.

Assessment coverage, which is available under the unit Dwelling Policy, applies when the building covered by the RCBAP is insured to 80 percent of replacement cost. The assessment coverage under the Dwelling Policy form will respond only to that part of a loss that exceeds 80 percent of replacement cost.

This assessment coverage also applies to common elements of any other insured building of the condominium association that is insured under the NFIP in an amount equal to the actual cash value of the other insured building. Loss payments, including assessment coverage, cannot exceed the maximum building coverage permitted for the building under the 1994 Reform Act. Assessment coverage also applies, up to the building coverage limits of the Dwelling Policy purchased, when there is no association policy (RCBAP).

Personal property owned by individual unit owners must be insured under an individual unit owner's Dwelling Policy.

c. General Property Policy

To purchase coverage under the NFIP on a nonresidential condominium building, a condominium association must use the General Property Policy form. Both building and contents coverages are available separately, in amounts up to $500,000 per_nonresidential building. The nonresidential unit owner also may purchase contents coverage using this policy.

In addition, a condominium association must use the General Property Policy form to purchase coverage on a residential building located in a participating Emergency Program community.

2. Cooperative Associations

The NFIP offers coverage for cooperatives through the General Property Policy form, with a maximum amount of building coverage up to $250,000 available to a residential cooperative. The entity that owns the cooperative, not the various unit members, is the named insured. A cooperative cannot be insured under the RCBAP.

3. Timeshares

NFIP coverage of timeshares is directly related to the jurisdiction's property ownership rights, as influenced by state law. The jurisdictions generally can be divided into two categories:

- Fee or real-estate ownership
- Non-fee interest, such as right-to-use.

States with fee ownership number slightly more than half of the jurisdictions.

In a fee-ownership jurisdiction, a timeshare is considered similar to a condominium. Therefore, the RCBAP is the required policy form for residential timeshares if the risk otherwise meets the underwriting requirements. That is, a timeshare unit owner must hold an interest similar to that of a condominium unit owner to be eligible for coverage under the RCBAP. If a timeshare is eligible for an RCBAP, it is precluded from being insured under a General Property Policy. A fee-ownership timeshare requires coverage placed through the timeshare's association on the RCBAP form. As with a condominium, lenders may consider the RCBAP policy, with the association as the named insured, as complying with the mandatory purchase requirements.

In a non-fee jurisdiction, the title remains with the building owner who has the full insurable interest in the real property, not with the unit occupants. In this situation, a General Property Policy form must be used for the building. The non-fee simple form of ownership is very similar to a cooperative, where no deed is held by the unit owner.

4. Secondary Market

In their selling guides for purchase of mortgages on condominium units, Fannie Mae and Freddie Mac specifically address the requirement of property coverage. These GSEs also recognize flood coverage carried by the association as complying with the mandatory purchase requirements.

a. Fannie Mae

Fannie Mae will accept building coverage provided under a Dwelling Policy form to supplement inadequate coverage carried by an association if the association carries 80 percent of replacement cost coverage on the condominium. If a condominium association declines to carry any flood insurance coverage, then each unit owner may purchase an individual policy to comply with Fannie Mae's requirements. The Fannie Mae guide also states that unless a higher maximum deductible amount is required by state law, the maximum allowable deductible is the higher of $1,000 or 1 percent of the face amount of the policy.

b. Freddie Mac

Freddie Mac’s guidelines are more restrictive than those required by the statute; it will not purchase loans on condominium units unless the association insures to full replacement value of all improvements. The policy deductible cannot exceed the higher of $1,000 or 1 percent of the policy's insurance limits.

E. KEY PROVISIONS

The preceding sections of these guidelines discuss specific provisions of the 1994 Reform Act and regulations as they apply to an individual borrower or policyholder. This section describes how certain key provisions of the 1994 Reform Act are to be implemented within the lending industry.

1. Tripwires

a. Loan Activity

As stated in the Congressional committee report, Congress views the making, increasing, extending, or renewing of a loan as a "tripwire" for compliance with the flood insurance purchase requirements. This tripwire occurs most frequently upon loan origination, e.g., when a lender knows or has reason to know whether the mandatory purchase requirements apply. Another trigger involves any situation that alerts a lender or servicer to a change in circumstances, e.g., a known map change, or the receipt of a notice to pay the premium to avoid policy expiration.

If a borrower executes a note on improved real estate as collateral for a personal loan, and the lender does not perfect a security interest or mortgage in the building itself, the loan is not a designated loan and, therefore, is not subject to the mandatory purchase requirement.

b. Loan Transfer or Purchase

The transfer or purchase of a loan among regulated lenders or servicers does not constitute the making of a loan, so it does not trigger the mandatory purchase requirement.

It is the lending regulators’ position that deeming a loan purchase as a regulatory tripwire could result in the imposition of duplicative and potentially inconsistent requirements on the seller and purchaser of loans sold in the secondary market. As a condition of purchase, a loan purchaser may require the seller to determine whether the building securing the loan is in an SFHA. The practice of requiring a seller to make a representation as to compliance with the mandatory purchase requirements also provides additional protection to a loan purchaser. This representation is particularly important when the loans are in communities that have SFHAs.

However, the GSEs do require flood insurance coverage on any loan transferred to or purchased by them. In the Supplementary Information section of the final regulations, the Federal regulators note that both Fannie Mae and Freddie Mac require their respective sellers and servicers to be in full compliance with the flood insurance statutes. See Fannie Mae Announcement No. 95-10 (June 8, 1995) and Freddie Mac Bulletins No. 94-18 (December 8, 1994) and No. 95-3 (March 13, 1995), included as Appendix 7.

Freddie Mac considers its purchase of a loan as serving as a tripwire, while Fannie Mae's guide requires compliance with the mandatory purchase requirements at the time of loan origination. Consequently, an originator or intermediate holder of a loan will be constrained in passing on a loan that does not meet the criteria of the GSE sales guides. An entity not directly covered by the Reform Act, such as a mortgage banker, will be indirectly required to satisfy the statutory flood insurance requirements if it or any subsequent party attempts to sell mortgage loans to Fannie Mae or Freddie Mac. An unregulated mortgage bank that extends a designated loan without flood insurance will be unable to pass that loan on to the GSE market.

In addition, although a conventional loan may be extended in a nonparticipating community, a lender may find it cannot pass the loan onto Fannie Mae and Freddie Mac. The GSEs have restated they will not buy mortgages secured by properties in nonparticipating communities if they are located in an SFHA. However, they will accept loans in nonparticipating communities that have not been mapped. The quality control measures instituted by the GSEs set the standard for the industry, even for transactions to private investors who are outside the GSE market.

When any loan is sold and servicing is transferred to the new servicer, notice of the identity of the new servicer must be provided to FEMA's designee.

c. Portfolio Review

A look-back or retroactive loan portfolio review, as well as a review made on a prospective basis, which may disclose uninsured risks, is encouraged but not required by the law. The 1994 Reform Act contains no express or implied language that obligates a regulated lender to review its portfolio of existing loans. Under GSE criteria, a lender or servicer is required to monitor loans sold to the GSE.

The 1994 Reform Act encourages lenders and servicers to develop policies and procedures to ensure that, when a determination has been made that a building securing a loan is located in an SFHA, coverage is obtained, or, if necessary, force placed. The lender or servicer also must ensure that a policy does not lapse after it has been placed at loan origination.

FEMA/FIA encourages a mortgagee or servicer to require the purchase of flood insurance at any time during the term of the loan when the lender determines that the building or mobile home is located in an SFHA. This position is intended to ensure that buildings located in SFHAs are covered by flood insurance, regardless of whether the area is designated as an SFHA by the Director of

FEMA before or after the loan is originated. For example, when a community or area is remapped by FEMA, buildings that were not located in an SFHA at the time the mortgage was made may later be identified to be in an SFHA.

A lender is notified of remapping through publication in the Federal Register of map change information pertaining to an individual community, or through a compendium that lists all changes during a specific time period. FEMA also offers a subscription service (for a fee) that provides information on map changes every 2 weeks. Some flood zone determination companies provide the service of monitoring map changes that influence the status of loans.

Apart from the requirements mandated on origination of a loan, a regulated lender need only review and take action on any part of its existing portfolio, i.e., "look forward," for safety and soundness purposes, or if it knows or has reason to know of the need for NFIP coverage. However, scheduled periodic reviews that track the need for flood insurance on loan portfolios are encouraged. The 1994 Reform Act does require lenders to check the status of security property for loans when triggered by the statutory tripwires. But the Reform Act did not add remappings to the list of statutory tripwires. Neither the Reform Act nor the agencies' regulations require lenders to monitor for map changes.

The GSE sales guides have broader requirements than the 1994 Reform Act in requiring lenders to continually monitor map changes and changes in community status under the program.

2. Safety and Soundness

Federal lending regulators view adequate flood insurance coverage as an important factor in measuring the safety and soundness of a lending institution that extends loans in at-risk areas. The existence of flood insurance is a component of prudent underwriting and protects the lender's ongoing interest in its collateral. Each lender must tailor its flood insurance risk management procedures to suit its particular circumstances. The Federal regulators encourage lenders to evaluate and modify their flood insurance programs as needed to comport with both the mandatory purchase requirements and principles of safe and sound banking that may be unique to a particular lender.

A lender's flood insurance needs vary widely depending on lending concentrations within the geographic areas it serves. For example, a high prevalence of loans in an SFHA requires particular vigilance. Institutions that are significantly exposed to the risks for which flood insurance is designed to compensate should determine the adequacy of flood insurance coverage by conducting periodic reviews, or reviews triggered by remapping of areas represented in their loan portfolio. Accordingly, a map change in a community that contains a significant number of loans in an SFHA merits a heightened analysis. The same principle applies to a regulated lender's purchase or transfer of existing loans in a community containing a special flood hazard.

In nonparticipating communities, lenders should have procedures in place to ensure that loans on properties in SFHAs where flood insurance is not available do not constitute a large portion of the institution's loan portfolio.

3. Table Funding

The regulations generally follow the RESPA definition in which table funding is defined as a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds. The typical table-funded transaction should be considered a loan made, rather than purchased, by the entity that actually supplies the funds, and thus is subject to the mandatory purchase requirements.

Table funding is a mechanism used in the "wholesale" mortgage lending industry for utilizing mortgage brokers in the production of mortgage loans. The brokers who originate the loans are independent contractors not subject to Federal regulatory supervision.

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 man-dated 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. Wholesale lenders provide the funds for loan closings and acquire the resulting loans, which they sell into the secondary market. Mortgage brokers receive compensation for surrendering the servicing income stream.

Under the regulations, lenders who provide table funding to close loans originated by mortgage brokers or mobile home dealers, such as described above, are deemed to be making, not purchasing, loans for purposes of the flood insurance requirements. Consequently, mortgage brokers are not obligated to comply with the 1994 Reform Act in these types of transactions. However, if any mortgage brokers are involved in the processing and underwriting of the application, the lender should contractually delegate to them the responsibility to comply with the various notice, form, and purchase requirements of the 1973 Act, thereby eliminating any duplication of flood determinations and borrower notices.

4. Impact on Servicers

The 1994 Reform Act addresses the role of servicers by sanctioning NFIP-related activities conducted on behalf of regulated lenders.

A servicer, as broadly defined in the 1994 Reform Act (42 U.S.C §4003(a)(11) and §4121(a)(11), may be a regulated lender or a private entity assisting a lender as an independent contractor. The provisions of the 1994 Reform Act apply to all banking institutions' subsidiaries and service corporations. If a servicer is a subsidiary of a regulated lender, it is included under the purview of the 1994 Reform Act. As discussed in Section C of these guidelines, the activities that apply to servicers include escrow, force placement, and zone determination, as well as the submission and receipt of notices. A servicer is directly involved in NFIP activities as a recipient of notices such as a copy of the borrower's Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance from the lender and the expiration notice from the insurer.

The regulations that address a servicer's activities treat loan servicers as acting on behalf of regulated lending institutions. Under the regulations, loan servicers are to be held answerable for their actions to the lender by means of contract. A lender thus may fulfill its duties under the 1994 Reform Act by imposing its responsibilities on the servicer under a loan service agreement. Accordingly, lenders should include in their loan servicing agreements language ensuring that the servicer will fulfill Federal insurance requirements for escrow, force placement, flood hazard determinations, and the various notices, with conditions for recourse. The Federal regulations state that where deficiencies are found in existing loan servicing contracts, lenders should revise these agreements to provide for the loan servicer to fulfill Federal flood insurance requirements. It would also be prudent to monitor the activity of servicing agents.

The mandatory purchase provisions do not apply directly to loan originators that are not banking institutions or to servicers that are not acting on behalf of a banking institution. However, these non-bank originators and servicers must see to it that loans they sell or service for a GSE meet the requirements of the 1994 Reform Act. Non-bank (e.g., mortgage broker), nonconforming loan lenders who do not originate for GSEs do not come under the authority of the Reform Act.

5. Private Flood Insurance

As part of the notification procedure in making a loan, lenders must inform prospective borrowers of the availability of coverage from private insurers as well as NFIP coverage. However, FIA recognizes the limited availability of flood insurance from the private insurance market.

A lender must consider the suitability of private flood insurance policies only when the mandatory purchase law applies. If NFIP coverage is not available in a particular community, or if the risk is otherwise not eligible for NFIP coverage, e.g., in a nonparticipating community or CBRA area, private flood coverage is an alternative. A lender has more discretion in selecting private flood coverage when NFIP coverage is not available.

When private flood coverage is being considered in lieu of a WYO or Direct NFIP policy, a lender is advised to review the FIA's criteria for the private insurer and the form of coverage. Specifically:

(a) The insurer should be licensed, admitted, or otherwise approved to do business in the jurisdiction where the building is located, by the insurance regulator of that jurisdiction, except as indicated in (b) below.

(b) In the case of nonresidential commercial property insurance issued under a policy of difference in conditions, multiple peril, all risk, or other blanket coverage, it should be sufficient if the insurer is recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the jurisdiction where the building is located.

(c) The private flood insurance policy should include a requirement for the insurer to give 45 days' written notice of cancellation or non-renewal to the insured with respect to the flood insurance coverage. The policy should also state that, to be effective, such notice must be mailed to both the insured and the lender or Federal agency lender, and must include information about the availability of flood insurance coverage under the NFIP.

(d) The policy should guarantee that the flood insurance coverage, considering deductibles, exclusions, and conditions offered by the insurer, is at least as broad as the coverage under the NFIP policies.

(e) Lenders should satisfy themselves that a mortgage interest clause similar to that contained in NFIP policies is contained in the policy.

An insurance policy that meets all of the above criteria meets the insurance purchase requirements of the 1994 Reform Act (42 U.S.C. §4012a). To the extent that the policy differs from the NFIP policy, the differences should be carefully examined before the policy is accepted as sufficient protection under the 1994 Reform Act.

The FIA notice that contains the criteria for non-NFIP underwritten coverage can be found in Appendix 11.

6. Regulatory Overview

The 1994 Reform Act expressly incorporates new regulatory sanctions into the law and indirectly influences the potential for civil liability. This subsection addresses the regulatory examinations and administrative sanctions, while Subsection E.7 deals with the issue of civil law liability.

a. Regulatory Examinations

As part of the 1994 Reform Act, Congress established a task force charged with studying the extent to which the Federal regulatory agencies and the secondary market enforce the 1994 Reform Act. The agencies are required to report their findings to Congress. Accordingly, lenders and servicers can continue to expect onsite examination by the regulatory entity primarily responsible for the supervision of the institution as part of their compliance examinations. Similarly, the GSEs will be reviewed by their oversight agency and must conduct a review of their sellers. The examination procedures may include reviewing a sampling of loan files.

The examiners may perform the following activities:

- Review an institution's practices dealing with flood insurance, including a suitable flood zone determination procedure that includes monitoring renewal of coverage and recordkeeping evidencing compliance.
- Ask for proof of the submission of the Notice to Borrower form.
- Observe whether the timing require-ments of the various notices have been met.
- Verify that the proper amount of coverage was placed in effect at the time of origination and remains in force throughout the renewal periods, with the lender shown as the mortgagee or loss payee on the policy.
- Check that the lender follows appropriate procedures when an area is reclassified because of a map revision.
- Confirm that a lender or servicer exercises force placement if there is failure to escrow or to continue a policy in effect.

The regulatory examinations will be tailored to the activities of the institution under review. For example, if an institution purchases servicing rights, the examination probably will include a review of the contractual obligations placed on the institution by the owner of the loans. Similarly, if the institution utilizes a third party to service loans, the contract with the third party may be reviewed to ascertain that the flood insurance requirements are identified and the compliance responsi-bilities are adequately addressed. If the institution transfers servicing of loans to another servicer, it must show it provided notice of the new servicer's identity to the FEMA designee within the prescribed timeframe.

If the institution utilizes a third party to perform flood zone determinations, it can expect a review of its contractual provisions to verify that compliance requirements are identified and covered, including the extent of the third party's guarantee of work.

Relevant parts of the Federal Financial Institutions Examination Council's (FFIEC) Examination Policies and Procedures can be found in Appendix 12.

b. Regulatory Penalties

Under the 1994 Reform Act, Congress for the first time designated a specific range of regulatory civil penalties that may be imposed administratively when it is found that a "pattern or practice of committing violations" has occurred.

The new law does provide penalties related to covered loans on which a lender fails to:

- Place insurance,
- Escrow flood premium on applicable loans,
- Provide notice requirements pertaining to involved loans, or
- Force place the insurance

in such a way that constitutes a "pattern or practice of committing violations" giving rise to an assessable event, 42 U.S.C. §4012a(f) and (g). Similar provisions exist with respect to GSEs.

The individual penalty amount is $350 per violation, while the aggregate amount of penalties per year that may be assessed against each institution may reach $100,000. Penalties assessed will be deposited in the National Flood Mitigation Fund created by the 1994 Reform Act (42 U.S.C. §4104d). Other remedial sanctions consist of unsatisfactory bank ratings, memoranda of understanding, and ultimately, cease and desist orders being issued against lending institutions. In coordination with the FFIEC, the regulatory oversight agencies have amended their uniform rules of practice and procedures to include action taken on the penalty sanctions provisions of the Reform Act.

7. Civil Liability

In legal actions where aggrieved borrowers have instituted actions against lenders for failure to obtain flood insurance coverage, the courts have stated that the mandatory purchase and notice statutes are designed for regulatory purposes to strengthen the NFIP.

The court rulings have concluded that the statute and lender regulations are not intended to make "incidental beneficiaries" of aggrieved borrowers who find themselves without NFIP coverage on flood-damaged structures located in an SFHA. In the past, the courts have ruled that the mandatory purchase statute grants no "implied private cause of action" on behalf of borrowers, enabling them to automatically recover based on the failure of a lender to comply with the 1973 Act. Courts have agreed with the lenders that the intent of the law is to promote sound land use management and lessen the payments made from the Federal Treasury for disaster assistance, as well as to protect the lenders themselves.