

Regulators Prove They're Serious about Flood Insurance Compliance

In case anyone thinks the regulatory agencies have forgotten about flood insurance compliance, think again. Recently, for example, the **Office of the Comptroller of the Currency (OCC)** issued a bulletin listing regulatory areas in which examiners will automatically assess fines if they find deficiencies. One of those was flood insurance. Consequently, as the regulatory agencies crack down, the list of banks falling down on their flood insurance compliance continues to grow.

Background

One of the aims of the National Flood Insurance Program (NFIP) is to reduce the amount of taxpayer's money spent for federal disaster assistance by allowing homeowners in communities prone to flooding to share in the cost of flood protection. In 1973, **Congress** passed the *Flood Disaster Protection Act* (FDPA) and expanded the NFIP. FDPA increased the limits of coverage and added the requirement that flood insurance be purchased as a condition of receiving federal aid in financing the construction, purchase, repair, or improvements of a building or mobile home located in a special flood hazard area of a community that participates in the NFIP.

Borrowers must be given advance notice that flood insurance is required. The insurance must be in place for the life of the loan. The most recent changes to the flood rules require lenders to force place flood insurance coverage if the borrower does not obtain the coverage within 45 days after notification.

One way lenders have gotten in trouble in the past, and it appears to be a continuing practice, is by loan officers not understanding they **cannot** waive the requirement for flood insurance. Because the loan officers are customer-oriented and want to work with the customer to make loans whenever possible, they have trouble grasping that the flood insurance requirement is **not** negotiable.

Latest Assessments

Several institutions have been assessed civil money penalties (CMPs) recently.

- Five Points Bank, Grand Island, Nebraska – Assessed a CMP of \$10,000 for the bank's failure to have flood determinations completed and adequate insurance on the collateral before the loans closed. Apparently, when a major federal flood control project was completed last year, the bank assumed the **Federal Emergency Management Administration (FEMA)** would update area flood maps and take most of the local vicinity out of the special flood hazard areas. No one at the bank had checked to see if the remapping had been done. Unfortunately, remapping only became official in October of 2003. The bank has overhauled its flood compliance program, including hiring a former examiner to the compliance staff, hiring a consultant for training, requiring lenders to create follow-up systems to track flood insurance expirations, and spot checking loans to ensure adequate coverage. All of this was, obviously, quite expensive. Ironically, when FEMA finalized the new flood maps, all but three of 90 customers who originally had property in a flood plain were taken out of the flood plain.
- CorTrust Bank, N.A., Mitchell, S.D. – Assessed a CMP of \$5,250 because two loans lacked adequate coverage or the coverage had been canceled and not renewed. The bank had to do a full search of 2,500 real estate-secured loans and came up with 35 loans that needed flood insurance. They determined the errors were primarily due to overzealous loan officers trying to be too kind to customers. To solve the problem, the bank got creative. In the future, loan officers have to pay for any CMPs resulting from their failure to secure adequate flood insurance on loans before the loans close. In addition, the bank added more training sessions and now requires loan officers to send a copy of insurance binders to the auditor before they can close on loans secured by property in a flood plain.

- Cumberland Bank, Franklin, Tennessee – Assessed a CMP of \$3,250 for a pattern or practice of violations of the flood insurance laws. The bank signed the Order of CMP Assessment, although it admitted no violations.
- Union Savings Bank, Cincinnati, Ohio – Assessed a CMP of \$30,000 for failing to: obtain flood insurance before closing loans, use required flood hazard determination forms, and notify borrowers of flood hazards within the required time period.
- First Federal Bank, Colchester, Illinois – Assessed a \$1,400 CMO for failure to maintain coverage on four loans resulting in a “pattern or practice of violations.” The errors were a result of believing that the loans were no longer in a flood plain after the U.S. Corps of Engineers and the local mayor assured them that their town was no longer considered to be in a flood zone. The problem was that FEMA had not officially changed the flood maps before the exam.
- Choice Financial Group, Grafton, North Dakota – Assessed a CMP of \$2,450 for making loan secured by a building or mobile home without requiring flood insurance for the term of the loan.

Conclusion

It is quite clear that the regulatory agencies are going to continue to search loan files for evidence of flood insurance compliance and that they will assess CMPs when they find violations. Institutions would be wise to do their own monitoring to ensure the affected loans do have flood insurance; conduct training frequently to ensure loan officers, auditors, loan secretaries, and loan operations personnel understand the flood insurance rules; and encourage senior management to enforce the efforts by setting some type of consequence for those lenders who have loans out of compliance. This can go a long way in saving the institution from paying CMPs and reducing reputation risk.