



FLOOD INSURANCE

the tides

By Michael J. Moye

I'VE BEEN ATTENDING the National Flood Conference since 1984, back when it was the Write Your Own (WYO) Flood Insurance Conference and attended mostly by representatives from insurance companies and the National Flood Insurance Program (NFIP). The 1984 conference was held around dining tables in the USAA Insurance Company cafeteria in San Antonio, Texas. (USAA was one of the first WYO insurance companies.) I don't remember the exact nature of the workshops, but they all centered around the question, "How are we going to make this thing work?"

are changing

The NFIP and its annual conference have changed. While lenders and servicers are most affected by the dramatic changes brought about by the National Flood Insurance Reform Act of 1994 (NFIRA), there have been other significant changes since, and more are on the way. Other venues exist for learning flood insurance compliance, but none are as concentrated as the flood conference, where you have the opportunity to discuss issues with federal regulators, flood insurance underwriters, insurance agents, flood map determination representatives, and other lenders and servicers focused on flood insurance.

Before the WYO program, federal insurance had been available through some insurance companies, but because of difficulties in auditing the handling of premiums, the government decided to establish a central facility from which all flood insurance was underwritten. Insurance companies no longer had that authority. Any duly licensed

agent could place insurance directly with the facility, but no insurance company was involved.

Because sales of flood insurance lagged behind expectations, then-Federal Insurance Administrator Jeffrey Bragg sought ways to once again engage the private insurance industry to take advantage of its agency and marketing networks. A financial control plan was devised that met both federal and private industry criteria, and the WYO program became a reality. Private insurance companies again began to market and underwrite the federal flood insurance policy, and hopes for increased sales rose.

Government and insurance conference attendees gathered each year but failed to engage the lending industry. As every reader of this article knows, borrowers do not volunteer to buy flood insurance. Most such insurance is purchased because it is required, and the lending industry has been tasked with requiring it of borrowers since the Federal Disaster

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Insurance Act of 1973. Instead of seeking input and participation from lenders, conference attendees gathered each year at subsequent conferences to discuss marketing techniques, underwriting requirements, financial responsibilities, and claim handling. If lenders were mentioned at all, they were blamed for not upholding their end of the deal. They were constantly accused of not requiring flood insurance when mandated to do so, and when they did require it at origination, they were accused of not keeping it in force.

While that criticism wasn't entirely unwarranted, there was no attempt to understand why the problem persisted, or what might be done to rectify it. Because I worked as an account executive for the WYO program at the time I didn't understand the lenders' perspective. Then in 1990 I became a manager for the wholly owned insurance agency of a regional lender. From the other side of the fence, the view was a lot different.

I continued to attend the flood conferences, though now my ears were tuned differently. I discovered there were a handful of other lender representatives who occasionally walked into the lion's den but kept a low profile to avoid drawing attention and scorn. It was not until the passage of the NFIRA in 1994 that the group decided it was time to come out in the open. If there was to be a change in attitude toward lenders, and if lenders expected to have any impact on change within the program directly, they had to get involved.

Lenders Become Integral Part of Conference

A few lenders approached the NFIP with the suggestion that the lending industry participate in the flood conference. They volunteered to organize workshops and conduct sessions on the problems and issues important to lenders. The NFIP was open to the idea, and lenders have been an integral part of the conference since. To do so, the lender's group formally organized as a not-for-profit corporation: the National Lenders' Insurance Council (NLIC). Soon the conference dropped WYO from its title; it is now known simply as the National Flood Conference.

Each year a representative of the NLIC sits on the Conference Planning Committee and helps create the conference outline. Lenders have become fully integrated into the discussions and now join in proposing solutions to issues and problems and helping each other wrestle with common

compliance issues.

Most years there are workshop panels of regulators and representatives from Freddie Mac and Fannie Mae. Lenders have the opportunity to ask questions, seek clarification, voice concerns, and offer suggestions. They also have the opportunity to meet with their peers to learn how others are coping with the demands of compliance and investor guidelines, and they return home having acquired new contacts and ideas while reaffirming the old ones.

2005 National Flood Conference

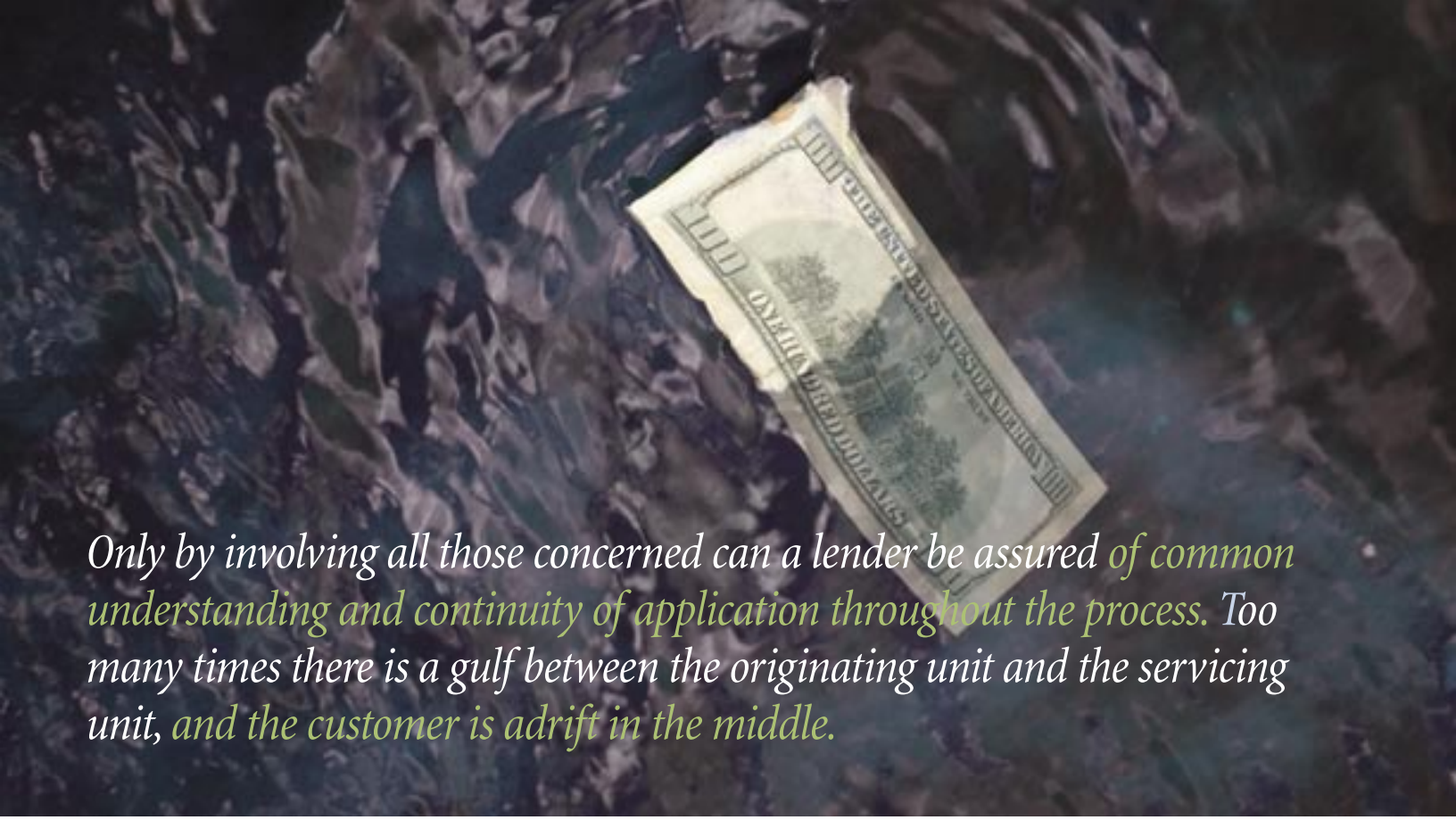
The theme of this year's conference, held in June on Marco Island, Fla., was "Tides of Change: Reforming the NFIP." While there has been no recent legislation prompting as many changes as did the NFIRA, every year has brought change—some good, some not so good.

In his opening remarks, David Maurstad, acting director of FEMA's Mitigation Division, spoke about some of the changes the NFIP is making to meet current challenges. First, it is testing packages of information to help policyholders better understand flood insurance coverage and limits along with a handbook that walks policyholders through the claims process step by step, including a provision for appeal. (This change was mandated by the Flood Insurance Reform Act of 2004.) The material is expected to be ready for implementation in October.

Maurstad also lauded the FloodSmart Program, the NFIP's public awareness and marketing campaign (www.floodsmart.gov). He said that policy growth had risen to nearly 3.8 percent since the program began in October 2003, and that the NFIP had "experienced 10 consecutive months of policy growth"—a program first.

Navigating the Treacherous Waters of Compliance

The most popular workshop at this year's flood conference was "Navigating the Treacherous Waters of Compliance." Panelists focused on how a lender can become (and stay) compliant. They advocated an "end to end" approach to solving the flood insurance riddle. Working with corporate legal counsel to interpret the compliance rules, a lender should develop a comprehensive corporate policy and engage an enterprise-wide team to administer and monitor that policy, including such lender divisions as originations, training, communications, servicing, legal,



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audit, and the internal insurance agency, if any. Third-party vendors should also be on the team. Only by involving all those concerned can a lender be assured of common understanding and continuity of application throughout the process. Too many times there is a gulf between the originating unit and the servicing unit, and the customer is adrift in the middle.

Other keys to compliance discussed in the workshop were the handling of flood zone certifications and disputes, flood insurance limit requirements and gap insurance management, elements of a successful lender-placed flood insurance program, vendor support expectations, necessary components to flood compliance reporting, and hints for managing flood compliance with customers. A Microsoft PowerPoint presentation of the workshop is available at www.nlic.org.

Stemming the Tide of Customer Confusion: Agents and Lenders Working Together

Another workshop culminated in a pledge by some lenders and agents to convene a task force between now and next year to seek solutions to selective issues. High on the list of areas that need resolution is the residential condominium building association policy (RCBAP). There is no clear process for the lender to determine the replacement value for property covered by the RCBAP compared to an association's other property insurance. The RCBAP will not insure all the property that is covered under other property insurance policies. Establishing a realistic replacement value for the RCBAP remains difficult, if not impossible.

Then, too, the relationship between the RCBAP and

the dwelling policy creates a special problem. Some lenders mistakenly believe they can require a unit owner to purchase a dwelling policy to help make up any perceived shortfall in coverage when the RCBAP is written at less than 80 percent of replacement value. Because the dwelling policy will not respond to shortfall assessments in such cases, the lender risks requiring potentially valueless insurance. Yet the lender deals with the unit owner, not the association.

Acceptable evidence of insurance is another area demanding attention. Too often the agent is willing to give less-than-adequate evidence, and too often the lender is willing to accept it. While the insurance may be in place, the evidence needs to be uncontestable. Both industries need to set and adhere to uniform standards.

To become involved in the task force or suggest an issue for the group to address, send an e-mail to info@nlic.org. Progress made by the group throughout the coming year will be discussed at the 2006 National Flood Conference.

The NFIP Contracts Reform Study

In March 2005, the American Institutes for Research (AIR) submitted to FEMA a report titled *The National Flood Insurance Program's Mandatory Purchase Requirement: Policies, Processes, and Stakeholders*. The report contains a number of recommendations developed from the survey that if implemented could positively or negatively impact a lender's operations.

Eliminate GSE Differences

For example, under the subsection "Essential Actions," Congress is urged to "eliminate the differences between

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federally regulated lenders, Fannie Mae, and Freddie Mac in the minimum insurance requirements that now exist for loans subject to the mandatory purchase requirement. All loans subject to the requirement should have the same minimum requirements for flood insurance.” Such a change ought to be championed because current differences create confusion and lead to errors in compliance.

Replacement Cost Limits Only

Another positive recommendation to Congress asks that it *require that the minimum amount of coverage in place for a designated loan be at least equal to the replacement value of a building or manufactured home or to the maximum limit of coverage made available through the NFIP with respect to the particular type of property, whichever is less, even when the principal balance of a loan is less than the replacement value.*

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Mandatory Life-of-Loan Transferability

Other recommendations to Congress have questionable utility and could create operational problems. For instance, prohibiting regulated lenders that use flood determination companies from “selling, purchasing, or securitizing loans that do not have life-of-loan flood determinations with transferability service.”

Update Mandatory Purchase Guidelines

The report encourages FEMA to “explore opportunities to exercise a leadership role in promoting compliance and in assisting the federal entities for lending regulation to meet their obligations related to flood insurance.” While the report reaffirms that FEMA is not and should not be engaged in regulating or enforcing compliance, it does offer suggestions whereby FEMA can make the compliance role easier.

One valuable recommendation advises FEMA to *update and revise the Mandatory Purchase of Flood Insurance Guidelines (FEMA 1999) in collaboration with key stakeholders, including the federal entities*

for lending regulation, federally regulated lenders, insurance companies and brokers, flood zone determination vendors, and government-sponsored enterprises. FEMA should ensure that the Guidelines address a specific audience, such as the lending community, rather than a generic audience. The Guidelines should be simplified, should provide examples to illustrate requirements, and should be user-friendly. The Guidelines presently assume considerable familiarity with flood mapping and floodplain management. If the Guidelines are intended to address the needs of regulated lenders, then entire sections can be deleted (e.g., the discussion of community-initiated map revisions) while other sections should be added. As an illustration, the format should be amended to facilitate lenders' explanation to borrowers why flood insurance is required (or recommended) due to a borrower's relative exposure to flood risk.

In a separate but related recommendation, the report encourages FEMA to

ensure the Guidelines' accuracy and their consistency with the rules and procedures of federal lenders and the federal entities for lending regulation as well as with the agency's Flood Insurance Manual. Revisions should address such topics as insurance during construction; escrow requirements for multifamily dwellings; loans in nonparticipating communities; coverage for condominiums; and the proper amount of civil money penalties that the federal regulatory agencies can impose. The use of plain English for the Flood Insurance Manual is highly desirable.

Allow Two Policies under MPPP

In a recommendation aimed at reforming the rules under which a mortgage portfolio protection policy (MPPP) can be written, FEMA is urged to

permit regulated lenders to use the MPPP to force-place a second NFIP policy (with the total coverage not to exceed the maximum coverage permitted by law). The NFIP currently has no means to assist the efforts of regulated lenders to comply with the mandatory purchase requirement when borrowers have coverage in amounts less than the minimum required by law.

Change is constant. Some change we can see coming. Some change catches us by surprise. The best we can do is attempt to get ahead of change and move it in a direction that benefits our efforts.

Regulator Recommendation

The report also includes recommendations for regulators. One of the more promising recommendations is for them to develop

policies or procedures to address satisfactorily potential coverage problems when there are two or more loans on a building or manufactured home. Secondary lien holders should not find themselves in a position where they must force-place coverage for the value of all loans on a building when they hold only a portion of the value of these loans.

The survey, initiated in March 2003, forms the basis for the recommendations. AIR's ultimate goal was to conduct an evaluation that would aid in improving NFIP goals. Find the entire report at www.fema.gov/pdf/nfip/mandpurch_0305.pdf. There is a lot to like and support in this report. Much of it will become the foundation for further change and reform, and its content is certain to be the subject of discussion at next year's National Flood Conference.

Freddie Mac Changes Guidelines

While the AIR report recommends that Congress pass legislation mandating replacement cost limits only, Freddie Mac has just moved in the opposite direction. For years Freddie Mac insisted that borrowers carry coverage in an amount that would ensure that claims were settled on a replacement cost basis. In August, though, it revised its guidelines to abandon that principle, making unpaid balance the target. Freddie Mac now requires limits of flood insurance coverage on insurable improvements to equal or exceed the lowest of the following:

- the unpaid balance of the mortgage or, if the mortgage is a second mortgage/HIL, the aggregate unpaid balance of the second mortgage/HIL and all outstanding superior liens on the mortgaged premises
 - the maximum amount of coverage currently sold under the NFIP for the type of improvements insured
 - the replacement cost of the insurable improvements
- Freddie Mac has also altered the provision for deductible selection. Previously the deductible could not exceed \$1,000. Now it may not exceed the maximum deductible amount currently allowed under the NFIP for the type of improvements insured.

In the release, Freddie Mac posited that the revision of its flood insurance coverage requirements was to match the amount required by the NFIRA. The lender claims that the

revision is the result of many sellers' and servicers' requests that its requirements be more consistent with those federally regulated institutions must follow.

This is not a small revision and like all change will meet with mixed reviews. Fannie Mae has been silent so far and still wants limits that ensure replacement cost claim settlements. Nonetheless, you may soon find Fannie Mae following Freddie Mac's lead. Until then, inconsistency still rules the market and this revision may create more problems than it solves, at least in the short run.

2006 National Flood Conference

Change is constant. Some change we can see coming. Some change catches us by surprise. The best we can do is attempt to get ahead of change and move it in a direction that benefits our efforts. If you're concerned about flood insurance compliance, put the 2006 National Flood Conference on your calendar now.

You can monitor information about the conference and be alert to registration materials by bookmarking <http://bsa.nfipstat.com>. Further, you can help shape the workshops for lenders and servicers by e-mailing suggestions, concerns, and issues to info@nlic.org. BC

ABOUT THE AUTHOR

Michael J. Moyer began his insurance career in 1972 with Maryland Casualty Company as a surety and fidelity bond underwriter. He has served in the industry as a marketing representative and independent insurance agent and was one of the first account executives for the National Flood Insurance Program's Write Your Own Program. He joined the banking industry in 1990 and retired from Bank of America in March 2005. During his banking career he managed commercial and personal lines insurance production for a wholly owned agency, assumed responsibility for optional and lender-placed fire and flood insurance programs, and managed flood zone determination arrangements for the bank. Currently, Moyer is president of Tenth Legion Insurance Consulting Corporation and president of the National Lenders' Insurance Council. He served as the lending industry representative on the congressionally mandated Technical Mapping Advisory Council, is a member of the Multi-Hazard Mitigation Council, and serves as a trustee for the Association of State Floodplain Managers Foundation. Reach him at mmoyer@tenthlegionconsulting.com.