

March 23, 2009

Michael Buckley, Acting Assistant Administrator
FEMA Mitigation Directorate
Department of Homeland Security
500 C Street S.W.
Washington, D.C. 20472

Sent via email transmission

Dear Mr. Buckley:

Please consider this letter a response by the National Flood Determination Association (“NFDA”) to the December 23, 2008 FEMA Memorandum “Release of the Standard Flood Hazard Determination Form” (the “Memo”) directed toward FEMA’s Regional Administrators and subsequently distributed to Write-Your-Own Companies (“WYO Companies”) through the January 22, 2009 NFIP bulletin.

BACKGROUND

As you are aware, flood determination services provided by NFDA member companies are an integral part of the overall federal flood program, facilitating lender compliance with the federal flood regulations. Through the mandatory purchase of flood insurance requirement, lenders rely upon our flood determinations to require the purchase of flood insurance by their borrowers, when applicable. The success of this program is evidenced by the hundreds of thousands of borrowers who have had flood insurance in place on their properties at the time of a flood and who have been able to rebuild and recover without seeking additional assistance from the federal government.

From time to time, a lender’s flood zone determination may differ in terms of the flood zone in which the building is located from the insurance company’s flood insurance policy. As described in the Memo, FEMA indicates that an appropriate solution to this would be to require or direct lenders to provide a copy of the lender’s Standard Flood Hazard Determination Form (“SFHDF”) to the borrowers who in turn could provide the form to the insurance agents for rating. **NFDA believes that lenders should have the option, as is currently the case, to develop their own policy and practice with regard to the handling of the SFHDF.**

EXECUTIVE SUMMARY

NFDA does not believe that a change in the regulations or guidelines should be made to require or direct lenders to provide the SFHDF to the borrower for the following reasons:

- The legislative history of the development of the SFHDF indicates that the purpose of the form is to facilitate lender compliance and to provide a standard form for lenders to use to determine if flood insurance is available and to be required on the loan. There is no evidence in the legislative history of a requirement that the form must be provided to the borrower or loan applicant.
- The legislative intent behind the promulgation of the federal flood regulations is primarily to protect the federally regulated lenders and the Federal Treasury against the financial losses caused by catastrophic floods. If Congress had intended for lenders to be required to provide the form to borrowers, Congress could have included an express requirement to do so similar to the requirement to provide the Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance to the borrower, when applicable.
- Federal and state courts across the nation have consistently interpreted the federal flood laws as not to have created a private right of action for borrowers against lenders. This important legal protection for lenders attempting to comply with the federal flood regulations could be eroded if lenders were required or directed to provide borrowers with the SFHDF. Legal arguments could be made that if borrowers are intended recipients of the form, then borrowers should be able to rely on it; therefore, borrowers should have a cause of action against their lender.
- Statements made in the Memo in regard to the federal flood regulations, particularly Determination fees (e.g. FDIC Regulations 12 C.F.R. 339.8) and Review of determinations (44 C.F.R. 65.17) are either not accurate or misleading to lenders attempting to comply with these regulations.

- Insurance companies may prefer to contract with their own provider for flood determinations in order to receive warranties in the event of a claim for damages brought by a customer.
- Due to the increased exposure to financial liability for lenders and their service providers which would be caused by this change, the costs of flood determinations would increase dramatically—costs which may be passed on to the borrower. This increased cost of obtaining a loan would be an obstacle in the lending process.
- This change would result in an expansion of the third party “guarantee” provided to lenders to include not only borrowers but ultimately any third party which happened to receive a copy.

For the reasons summarized above, we strongly advise FEMA to reconsider the position described in the Memo which, in NFDA’s opinion, is a dramatic change in your guidelines to lenders. We foresee unintended negative consequences if such a change were fully implemented, including a considerable increase in financial exposure to lenders and their service providers and a significant increase in the costs of flood determination services, thus creating an obstacle to the lending process itself.

NFDA urges you to consider the history and the legislative intent behind the program and the flood determination form itself, along with the substantive case law on the issue, all of which we believe support maintaining the current use of the form to the benefit of the lending institutions.

LEGISLATIVE HISTORY

“Flooding has long been the costliest and most devastating disaster in the United States ... [and in] the face of mounting flood losses and escalating costs of disaster relief, the U.S. Congress created the National Flood Insurance Program (“NFIP”)” (*Mandatory Purchase of Flood Insurance Guidelines*, September 2007, FEMA 186, p.1). Authorized by the National Flood Insurance Act of 1968, 42 U.S.C. §4001, the NFIP made federal flood insurance available to residents in participating communities which agree to enforce floodplain management and hazard mitigation guidelines as part of their building and development ordinances. The desired effect of this three-pronged approach (mitigation, floodplain management and insurance) was to decrease federal disaster assistance expenditures from flood and to shift that burden to a self-sustaining insurance program. However, this voluntary participation model yielded too few subscribers to reach the desired effect, thus leading Congress to pass the Flood Disaster Protection Act of 1973 (“FDPA”) which promulgated the mandatory purchase of flood insurance requirement. For the first time, federally regulated lenders were obligated to require flood insurance on any loan (in an amount at least to cover the lender’s interest in the collateral) secured by improved real estate in a FEMA-designated Special Flood Hazard Area (“SFHA”) in a participating community. The mandatory purchase requirement was designed to protect federally regulated lenders and the Federal Treasury by ensuring that loan collateral is protected against flood damage. As contemplated by Congress in passing the FDPA, “once the provisions of this bill are fully implemented, there will be a new savings of substantial amount to the Federal Government” (Senate Report No. 93-583 [1973]).

In 1994, Congress passed the National Flood Insurance Reform Act (the “NFIRA”) to strengthen lender compliance with the mandatory purchase of flood insurance requirement. The NFIRA gave regulated lenders the authority to force-place flood insurance when necessary, established an escrow requirement for flood insurance, and instituted civil penalties and fines for lender non-compliance. In addition, pursuant to the NFIRA, FEMA and the Federal Regulators developed the Standard Flood Hazard Determination Form [FEMA Form 81-93] in order “to facilitate compliance with the flood insurance purchase requirements” 42 U.S.C. 4104b(b). The SFHDF was developed to provide lenders a “standard form for determining ... whether the building or mobile home is located in an area ... having special flood hazards and in which flood insurance is available” 42 U.S.C. 4104b(a). A SFHDF is required for each loan and may be completed by the lender or by a third party (e.g. flood zone determination company) provided that the third party “guarantees the accuracy of the information” 42 U.S.C. 4104b(d). “Neither FEMA nor the lending regulators have designated standards for what constitutes an adequate guarantee” (*Mandatory Purchase of Flood Insurance Guidelines*, p. 37); however, whether or not the lender completes the flood determinations themselves or uses a third party, the non-delegable obligation and ultimate responsibility for the determination and for requiring flood insurance is with the lender. Similarly, whether or not the lender completes the determination or pays a third party provider, a lender may choose to charge the borrower for the costs of the determination but only under certain circumstances, including

if the determination is made in association with “the making, increasing, extending, or renewing of the loan” 42 U.S.C. 4012a(h). Recognizing that questions may arise about the accuracy of a lender’s flood determination, Congress established a process (Letter of Determination Review) as part of the federal law which allows a lender and borrower to jointly request a review of the flood determination by FEMA provided such request is made within 45 days of the lender’s notice to the borrower and other conditions are met 42 U.S.C. 4012a(e).

LEGISLATIVE INTENT

As described above, Congress’ intent when enacting the provisions of the NFIRA (including those related to the SFHDF) and the preceding legislation was to protect lenders and the Federal Treasury from the financial consequences of flood disasters. The SFHDF is the document lenders utilize to ensure their compliance with the mandatory purchase of flood insurance guidelines which, in turn, serves to ensure that flood insurance is in place for designated loans in support of the legislative intent.

If Congress had intended for borrowers to receive and rely upon the lender’s flood determination, Congress could have included an express requirement similar to the notice requirement set forth in 42 U.S.C. 4104a. When loans are to be made, increased, renewed or extended on properties within a SFHA, lenders must provide a Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance (e.g. FDIC Regulations, Appendix A to 12 C.F.R. 339) to the borrower to advise the borrower of the flood insurance requirements on the loan. When questioned as to whether the SFHDF and the notice to the borrower could be combined in one document, the Federal Regulators explained that the “documents have different purposes”, namely, that the “SFHD form must be used in connection with all loans to determine whether the security property is or will be located in an area having special flood hazards” while the notice need only be prepared for and provided to a borrower to notify them of the loan’s flood insurance requirements when the property is located in a SFHA (“Loans in Areas Having Special Flood Hazards,” Joint Final Rule, 61 FR 45684, August 29, 1996). There is no mention in the Federal Regulators’ Joint Final Rule as to the expectation that the lender would be required to provide the flood determination to the borrower. Furthermore, regardless as to whether or not the regulations allow for a lender “to charge a reasonable fee for the costs of making a flood hazard determination under specified circumstances” (*ibid.*), there is nothing in the Joint Final Rule that supports the position that simply by permitting this cost to be passed on to the borrower that somehow the borrower is bestowed the right to rely upon the form and its contents.

During the development of the SFHDF, FEMA considered providing direction to lenders as part of the official instructions that the lender should provide the completed flood determination to the borrower so that the borrower in turn could provide the document to the insurance agent to facilitate the writing of the flood insurance policy. However, upon reconsideration, as set forth in the Joint Final Rule, FEMA “revised the wording on the instructions to include the word ‘may,’ to make the direction optional” (“Standard Flood Hazard Determination Form,” Joint Final Rule, 61 FR 35276, July 6, 1995). **The current instructions to the SFHDF state that “a copy of this completed form may be provided to an insurance agent” (Standard Flood Hazard Determination Form, FEMA Form 81-93, effective December 2008). NFDA does not object to this optional direction, however, we strongly object to any change which would make this a requirement. Congress has not provided an express statutory requirement of lending institutions to share this form with third parties; therefore, the NFDA believes that lending institutions themselves are in a better position to determine their policies with respect to specific aspects of their compliance program—“each lender is generally in the best position to tailor its flood insurance policies and procedures to suit its business” (“Loans in Areas Having Special Flood Hazards,” Proposed Rules, 60 FR 53962, October 18, 1995).**

CASE LAW

In addition to understanding the legislative intent behind the federal regulations, we also have the benefit of judicial interpretation of these regulations. From time to time, lenders have found themselves as defendants in lawsuits filed by borrowers who perceive a grievance against lenders arising out of the federal flood regulations. **In considering the many cases that have come before the courts, the consistent interpretation of the federal flood regulations by both state and federal courts is that these regulations, including those related to the SFHDF, are intended primarily to benefit the lenders and the Federal Treasury and not the individual borrower¹.** In *Arvai v. First Federal Sav. & Loan Assoc.*, 698 F.2d, for example, the U.S. Fourth

¹ See *Wentwood Woodside I, LP v. GMAC Commercial Mortg. Corp.*, 419 F.3d 310, 323 (5th Cir. 2005) (no private cause of action against lender); *Dollar v. NationsBank of Georgia, N.A.*, 534 S.E.2d 851 (Ga. Ct. App. 2000); *Laurent, et al. v. Flood Data Servs.*,

Circuit Court of Appeals upheld a lower court decision that borrowers who borrow money from a federally regulated lender “were not in a class for whose especial benefit the Act was passed.” As such, borrowers did not have a private right of action to bring a suit against lenders for the lenders’ actions or inactions under the federal flood statutes.

When one federal court specifically considered the SFHDF and the legislative intent behind 42 U.S.C. 4104b, the court concluded that an “[a]nalysis of the text of the statute, its context . . . and its legislative history lead inescapably to the conclusion that Congress did not intend to create a private cause of action under § 4104b” *Cruey v. First American Flood Data Services*, 174 F. Supp. 2d 525. This particular case was brought against First American Flood Data Services as the flood determination provider for a federally regulated lender; however, the court’s analysis was based upon the legislative intent of the federal statute governing lenders themselves.

Therefore, the judicial interpretation of the federal flood statutes supports the position that the requirements under the NFIRA and the preceding legislation—including the purpose and use of the SFHDF—are not specifically intended to directly benefit the borrower, thus care should be taken by FEMA to not provide direction to lenders which is contrary to this intent.

DISCUSSION

Recently, considerable attention has been given to the occasional discrepancies that may occur between a lender’s flood zone determination and an insurance agent’s or company’s determination completed for the rating of a flood insurance policy. A possible resolution, as is described in the Memo, would seem to be for the insurance agent or company to receive a copy of the lender’s flood determination and rely upon it for rating of the insurance policy. While we do not object to the lender having the option of providing their flood determination to the borrower who, in turn, could provide it to the insurance agent/company, **we do object to any indication that this is the required or directed practice as is suggested in the Memo.**

Insurance Industry Liabilities

Insurance companies understandably may choose to not rely upon the lender’s flood determination. As with lenders, insurance companies and agents find themselves as defendants in lawsuits filed by their customers—the property owners—who claim to have relied to their detriment upon advice from their agents. Whether it’s a question of deciding not to purchase flood insurance, or whether it’s simply a mis-rating of the insurance policy, insurance companies and agents realize that they have exposure when rating the flood insurance policy. Given that the insurance company or agent did not purchase the lender’s flood determination and has no contract or relationship with the lender’s flood determination provider, insurance companies and agents have no warranty to rely upon in the event of a legal action or claim brought by a policyholder. Understandably, therefore, insurance companies and agents prefer to receive a flood determination directly from a provider with whom they have a contractual relationship including appropriate warranties.

Letter of Determination Review

The Memo implies that evidence of Congress’ intent to have lenders provide borrowers with a copy of the SFHDF is the Letter of Determination Review (“LODR”) process established pursuant to the “Review of determination regarding required purchase” provision of the federal law 42 U.S.C. 4012a(e). **Importantly, there is nothing within the FEMA regulations which supports the position taken in the Memo that a borrower must receive a copy of the lender’s SFHDF in order to pursue a LODR.** FEMA regulations describe the process as a joint request between lender and borrower. The joint request must be submitted to FEMA within 45 days of “the lender’s notification to the borrower that the building or manufactured home is in the SFHA and that flood insurance is required” and must include a copy of the “lender’s notification to the borrower” as described above (44 C.F.R. 65.17). However, there is no reference to the borrower being required to provide a copy of the completed SFHDF as received by a lender. In fact, as part of the joint request, a “legible, hard copy of all technical data used in making the determination” and a copy of the completed SFHDF must be submitted, which naturally would come from the lender. A borrower can make a decision about the need to pursue a LODR based upon the lender’s notification that the property is within the SFHA and that flood

Inc., et al., 766 N.E.2d 221 (Ohio Ct. App. 2001); *Cruey, et al. v. First American Flood Data Servs., Inc.*, 174 F. Supp. 2d 525 (E.D. Ky. 2001); *Pippin v. Burkhalter*, 279 S.E.2d 603 (S.C. 1981); *Lehmann v. Arnold*, 484 N.E.2d 473 (Ill. App. Ct. 1985); *R.B.J. Apts., Inc. v. Gate City Sav. & Loan Ass’n*, 315 N.W.2d 284 (N.D. 1982); *Arvai v. First Federal Sav. & Loan Ass’n*, 698 F.2d 683 (4th Cir. 1983).

insurance is to be required. While the lender may indeed provide, and is permitted to provide, a copy of the completed SFHDF to the borrower in this situation, it is not accurate for FEMA to declare as is done in this Memo that the requirements of the LODR process support the position that the lender should provide a copy of the form to the borrower.

Increased Liability and Claims Exposure

Negative consequences for the lenders and an adverse impact upon the lending process could occur should FEMA and the Regulators require or direct lenders to provide copies of the completed SFHDF to their borrowers. First of all, we would expect an almost immediate increase in the number of claims and lawsuits brought against lenders. Lenders, whose current policy and practice may be to not provide the flood determination to the borrower, would be required to provide the form, thus creating additional exposure. Courts would have to reconsider their historic position on the interpretation of the statute, possibly eroding the legal protection afforded to lenders whose sole involvement in the flood determination process is due to federal compliance requirements. Whereas, historically 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” (*Mandatory Purchase of Flood Insurance Guidelines*, p. 60), borrowers’ attorneys would have new arguments to make given that the regulations would require that the borrower was to receive a copy of the completed SFHDF. Plaintiffs’ attorneys would certainly argue that if borrowers are intended recipients of the form based upon this requirement, then borrowers are intended beneficiaries and should be able to rely on it; therefore, borrowers should have a cause of action against their lenders.

Furthermore, the types of claims that lenders would face would not be limited to uninsured flood-damaged property claims if this change was made. Borrowers who were intended to receive and benefit from the SFHDF may reasonably argue that they had a right to make other decisions for their own purposes based upon the information on the flood determination. For example, a borrower receiving a lender’s flood determination during the loan application or closing process may claim that the decision to purchase a given property was made based upon the location of the property outside of a flood hazard area, as indicated on the completed SFHDF. Presently, when faced with these claims, the lender or the lender’s service provider can point to the intended purpose of the form, which is to “help ensure that required flood insurance coverage is purchased for buildings and mobile homes located in SFHAs, and ... [to] help federal entities for lending regulation in assuring compliance with these purchase requirements” (“Standard Flood Hazard Determination Form,” Joint Final Rule, 61 FR 35276, July 6, 1995). If lenders were required to provide the flood determination to borrowers, we would anticipate that lenders’ or service providers’ arguments would be challenged.

Increased Cost

With a considerable increase in financial exposure, lenders would need to reconsider what is currently paid for by borrowers as part of the closing costs for the flood determination service. **Per the federal regulations, lenders are permitted, but not required, to charge borrowers a reasonable fee for the flood determination service in certain circumstances. Even though the lender may pass on the cost of the flood determination to the borrower in certain circumstances, this does not change the purpose of the SFHDF or the party intended to benefit therefrom. Similar to appraisals and property mortgage insurance, the lender may pass on the costs to the borrower, however, the products or services are expressly and exclusively provided for the benefit and use of the lender.** Presently, the charges to borrowers for the flood determination search range from \$5 to \$20; however, to properly account for the dramatic increase in financial exposure, charges for flood determinations would need to increase exponentially, thus creating an additional obstacle in the lending process. Potential purchasers of property who are interested in a property’s potential exposure to flood hazards have professional services available to them as well, such as provided by surveyors and engineers, which would be better suited (and at a more appropriate fee) to provide the type of professional assurance that a property owner investing hundreds of thousands of dollars into a property would require.

Expansion of Guarantee to Third Parties

As previously discussed, lenders are ultimately responsible for compliance with these requirements and with ensuring that flood insurance is in place on designated loans, even in the event that the lender obtains SFHDFs with requisite guarantees from a third party provider. Thus, any exposure to additional liability related to flood determinations potentially extends to the lending institutions themselves. As for the guarantee, as required by 42 U.S.C. 4104b(e), we foresee that another possible consequence of this proposed change to be the expansion

of the guarantee to third parties. If the borrower is an intended recipient of the flood determination then the borrower should be able to rely upon the form for its own purposes, as previously discussed. One such purpose may be to provide the completed SFHDF to a prospective buyer of the property in the future. Now the guarantee has extended even further, opening up service providers to additional liability to unforeseen parties. We do not believe this is consistent with the legislative intent, as set forth in FEMA's Joint Final Rule:

Many services are provided to the lending community in the course of a loan application. The information provided is generally guaranteed by a contract for services or information, or because an individual is licensed or has expertise in a particular field. The guarantee for a flood hazard determination performed by a third party is based on the lender's needs and negotiations between the third party and the lender. This is considered standard business practice. ("Standard Flood Hazard Determination Form," Joint Final Rule, 61 FR 35276, July 6, 1995)

While the regulations do not prescribe what constitutes an adequate "guarantee", the lending industry and the flood determination industry have developed standard and acceptable practices governed by the contract between the parties which ensure that the lenders' interests are protected and that the lender will be in compliance with federal regulations. The guarantee extended by the flood determination provider to the lender is not intended to extend to third parties. Any such expansion would result in additional exposure to the third party provider, thus necessitating the need to dramatically increase the costs of the services which ultimately may be charged to the borrower, as described above.

Changes in Processing

Finally, if this dramatic change was made, many lenders who have developed their own policies and business practices in order to fulfill their compliance requirements would be faced with making considerable, perhaps burdensome, changes. Currently, the requirement with respect to the SFHDF is only that the lender must be able to retrieve the information within a reasonable period of time upon the request of the Regulator. The information may be maintained electronically. There is no requirement that lenders print and preserve the SFHDF in order to provide it to the borrower.

CONCLUSION

NFDA and its member companies are very concerned about the possible impact of this Memo. We strongly urge FEMA to reconsider the position described in the memorandum and to not consider any further changes in regulations and guidelines with respect to the handling of the SFHDF by lenders. We believe the current situation in which lenders "are neither required to provide nor prohibited from providing ... the borrower with a copy of the form" (*Mandatory Purchase of Flood Insurance Guidelines*, p. 38) continues to be the best practice for FEMA and the Federal Regulators. This approach is consistent with the legislative intent of the NFIRA and preceding legislation and is also consistent with established and accepted case law from federal and state courts across the nation.

NFDA appreciates FEMA and the flood program and what the program does for the nation and its citizens. We are committed as an association to continuing to be an active stakeholder and to provide products and services which will support FEMA's intentions with the program. We appreciate your time and consideration of these important points and I invite you to contact me directly should you wish to discuss in further detail. I can be reached, at your convenience, at 1-800-833-6347, ext. 642.

Sincerely,



Leila Taha, President
National Flood Determination Association

Cc: Edward L. Connor, FEMA Mitigation Directorate; Pamela Mount, Office of the Comptroller of the Currency; Vivian Wong, Federal Reserve System; Mira N. Marshall, Federal Deposit Insurance Corporation; Ekita Mitchell, Office of Thrift Supervision; Mark L. Johansen, Farm Credit Administration; Moissette I. Green, National Credit Union Administration