



OCC Provides Guidance on Flood Insurance Issues Applicable to Commercial Loans

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The Office of the Comptroller of the Currency (“OCC”) has issued interpretive letter #1156 (the “Interpretive Letter”) providing guidance on (i) evaluating the appropriateness of a private flood insurance deductible when there are multiple structures on a commercial property, (ii) the treatment of automatic extensions of a commercial credit facility under flood insurance requirements, and (iii) ensuring compliance with federal flood insurance requirements for lenders that are participating in one tranche of a multi-tranche credit facility.

Evaluation of Deductible in a Private Flood Insurance Policy

Under the current federal flood insurance regulations, a lender is prohibited from originating a loan secured by a building that is located in a special flood hazard area in a participating community unless the building (and contents) securing the loan is covered by flood insurance. If the collateral securing the loan includes more than one building, the lender is to determine the total amount of insurance required on each building and add the individual amounts together. The total amount of required flood insurance would then be the lesser of the outstanding principal balance of the loan, the maximum amount of insurance available under the National Flood Insurance Program for the type of buildings, or the combined insurable value of the buildings. The amount of total required flood insurance can be allocated among the buildings used to secure the loan in varying amounts; however, each building must have some coverage.

Lenders are also directed to determine the reasonableness of the flood insurance deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and the lender. For example, if a flood insurance policy includes a deductible amount that exceeds the insurable value of one or more buildings securing the loan, the federal agencies have opined that as a factual matter, there would be no coverage for that building in the event of a loss. This would be inconsistent with the statutory and regulatory requirement that a lender is prohibited from making a loan secured by a building located in a special flood hazard area in a participating community unless the building is covered by flood insurance.

The Interpretive Letter addresses an inquiry regarding the evaluation of a deductible in a private flood insurance policy. It was requested that the OCC review an alternative approach to evaluating such deductibles. The proposed approach would allow a bank to accept a deductible amount if the deductible amount is no more than ten percent (10%) of the coverage amount and the aggregate insurable value of the structures and their contents on the commercial property is greater than the deductible amount.

The OCC applied this approach to a hypothetical scenario where a \$100 million flood insurance policy covers 75 buildings with a deductible of \$2.5 million; 35 of the buildings have an insurable value of \$3 million each and 40 of the buildings have an insurable value of \$50,000 each. In such a scenario, the aggregate insurable value of the structures and their contents on the commercial property is \$107,000,000 (35 buildings with a combined insurable value of \$105,000,000 and 40 buildings with a combined insurable value of \$2,000,000). The OCC found that the alternative approach could result in the bank accepting the policy even though the deductible amount is more than the insurable value of the 40 buildings valued at \$50,000, which would, in effect, provide no coverage for those 40 buildings in the event of a loss. Accordingly, the OCC affirmed its position that a private flood insurance policy for which the deductible amount exceeds the insurable value of one or more of the buildings securing a loan does not, as a factual matter, provide coverage for that building in the event of a loss and, therefore, would not comply with the statutory and regulatory requirement that, for a mortgage loan secured by a building in a special flood hazard area, the building must be covered by flood insurance.

Automatic Extensions of a Commercial Credit Facility

The Interpretive Letter also responds to a request for guidance on the treatment of automatic extensions of a commercial credit facility under flood insurance laws. The OCC determined that an automatic extension of a credit facility that is agreed upon by the lender and the borrower at the origination of a loan and is memorialized in the credit agreement does not constitute a “make, increase, extend or renew” (“MIRE”) event that would trigger the federal flood insurance requirements because the automatic loan extension was anticipated in the original loan agreement.

Multi-Tranche Credit Facilities

The last item in the Interpretive Letter also provides guidance on whether a lender must consider any MIRE event and any “cashless roll” (an exchange of an existing loan for a new or amended loan without any transfer of cash) of which it becomes aware in any tranche of a multi-tranche credit facility, regardless of whether that lender participates in the affected tranche. In responding, the OCC referenced guidance it has issued with respect to loan syndication or participation. The OCC set forth that it believes a multi-tranche credit facility is similar to loan syndication or participation and therefore expects that a lender participating in a multi-tranche credit facility follow such guidance.

Accordingly, the OCC expects a lender participating in a multi-tranche credit facility to perform upfront due diligence to ensure that the lead lender in the multi-tranche credit facility has adequate controls to monitor the loan on an ongoing basis for compliance with flood insurance requirements. While each lender participating in a tranche in a multi-tranche credit facility remains individually responsible for ensuring compliance with the flood insurance requirements, the lender can fulfill this obligation through the upfront due diligence and ongoing monitoring for compliance with flood insurance requirements by the lead lender/administrative agent. Therefore, the OCC does not expect a lender participating in one tranche in a multi-tranche credit facility to be responsible for taking direct steps to ensure compliance with flood insurance requirements in connection with a MIRE event or cashless roll that occurs in a tranche in which the lender does not participate.

The Interpretive Letter can be accessed [here](#). The OCC stated that it will recommend that the issues raised with respect to the evaluation of the deductible in a private insurance policy and lender participation in a multi-tranche credit facility be incorporated into future revisions to the Interagency Questions and Answers Regarding Flood Insurance issued by federal banking regulators.

If you have any questions regarding the Interpretive Letter or federal flood insurance requirements in general, please feel free to contact Joseph D. Simon at [516-357-3710](tel:516-357-3710) or via email at jsimon@cullenanddykman.com, Kevin Patterson at [516-296-9196](tel:516-296-9196) or via email at kpatterson@cullenanddykman.com, Diana R. Acosta at [516-357-3739](tel:516-357-3739) or via email at dacosta@cullenanddykman.com, or Elizabeth A. Murphy at [516-296-9154](tel:516-296-9154) or via email at emurphy@cullenanddykman.com.

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