

## Frequently Asked Compliance Question

May 15, 2015

### Question

In what situations must we require that our borrowers carry contents coverage as part of their flood insurance?

### Short Answer

If the lender perfects a security interest in content assets that are housed within a structure that also secures the loan - and that structure is located in a specially designated flood hazard area - the lender must obtain contents flood insurance coverage. Further, a lender should have procedures for making a reasonable determination of the value of the collateralized contents to ensure an appropriate amount of coverage is in place.

### Answer Details

In order for contents coverage to be required, the following must apply:

- The Bank must have a security interest in the building and contents
- The building serving as collateral is located in a Special Flood Hazard Area
- The contents secured are stored within the building.

The requirement to obtain contents flood insurance coverage applies whether the lender intends to perfect a security interest in the contents assets as either a primary underwriting concern or merely as an abundance of caution. During a December 3, 2012, Flood Insurance teleconference, the FDIC clarified that the method by which contents are collateralized does not matter. This means that the institution does not need to file a UCC lien to have effectively taken contents as collateral if the mortgage document alone contains language indicating the security of contents.

Institutions are also required to have a procedure for determining the value of contents to be taken as collateral for the purposes of evaluating the flood coverage requirement. Banks have flexibility in how they will perform this calculation, but the analysis must be consistently applied whenever flood coverage for contents is required. Once that determination has been performed, the institution may reduce the required amount of contents coverage to meet the thresholds of minimum coverage mandated by FEMA. For example: A commercial loan of \$225,000 is secured by a retail store, valued at \$200,000 and inventory worth \$50,000. As only \$225,000 in total coverage is required, it would be permissible to obtain a flood policy for \$200,000 of building coverage and \$25,000 of contents coverage.

If you are interested in an audit of your lending procedures or a customized flood review, please contact Brian Shea at [bshea@wolfandco.com](mailto:bshea@wolfandco.com) or Erica Torres at [etorres@wolfandco.com](mailto:etorres@wolfandco.com).