

# Making the Case for Flood Insurance Testing & Audit Preparation

#1

## Case Study

### Residential Flood Insurance Testing

#### Background:

*Clayton has been engaged by multiple clients, including banks, MSR owners and servicers who must adhere to FDPA regulations, to conduct flood insurance testing. Some clients were simply seeking flood testing as part of their normal QC program and subservicer or vendor oversight. Other clients engaged Clayton to either help prepare for an audit or had already been audited by a regulator, such as the OCC, and needed ongoing flood testing support. Often, requests to help with audit preparation or testing after a completed audit have led to extended partnerships, which have included ongoing daily or monthly testing of loans to ensure continuous compliance and ongoing monitoring of policies, procedures and controls.*

#### Process Improvements Gained from Clayton's Testing & Continued Partnership with Clients:

Clayton has reviewed for direct regulatory violations, as well as effective bank processes and controls, including required flood coverage amount and effective dates, document processing and accuracy and timeliness of required communication to the borrower. Throughout testing, Clayton has regularly discovered that vendors have not consistently completed flood coverage worksheets during key servicing events. This inconsistency has caused issues with force placement, as well as insufficient coverage, throughout the life of affected loans. Communication between banks and vendors has also been found to be lacking and has caused improper delays in the transfer of

essential flood documentation, thereby causing inaccurate tracking and documentation of all policy information, untimely force-placement actions, and force placement at incorrect coverage amounts or effective dates. Additionally, across different projects in testing, Clayton has noted improper letter cycle adjustments often prolonged the 45-day period for borrowers to provide insurance prior to force placement. Vendors have also inconsistently or incorrectly used insurable value, and often in testing, there have been insufficient procedures for handling special situations such as multiple structures, cooperative loans and construction loans.

In a few cases, and as a direct result of Clayton's testing, clients completed an overhaul of their policies and procedures regarding their insurance servicing vendor and partnered with Clayton to continue ongoing testing based on the new procedures to monitor the vendor's actions and identify any areas of non-

compliance. Utilizing this testing, our clients were able to remediate errors efficiently and in a timely manner with Clayton's continued support. These partnerships, in some cases, later evolved into assistance with subsequent vendor conversions and ongoing monitoring for the new vendors.

**#2**

**Case Study**

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## Commercial Flood Insurance Testing

**Background:**

*Clayton has been engaged by multiple clients, including banks, MSR owners and servicers who must adhere to FDPA regulations, over the years to conduct commercial flood insurance testing. Some of these clients simply wanted to have commercial flood testing as part of their normal QC program and subservicer or vendor oversight. Other clients engaged Clayton to either help prepare for an audit or had already been audited by a regulator like the OCC or FRB and needed ongoing flood testing help.*

**Process Improvement Opportunities Arising from Clayton's Findings:**

During Clayton's evaluation, a majority of findings were focused on adequacy of coverage (particularly for contents coverage), the content of the 45-day force placement notices and timeliness of force placement. In some cases, and as a direct result of Clayton's testing, clients have further consulted with Clayton to gain advice regarding policies and procedures opportunities.

Throughout client commercial testing, Clayton has regularly identified inaccurate information on force placement notices and has proposed establishing a standard notice format and clear written procedures for ensuring accurate information within the notice. Clayton has also recommended maintaining a consistent method of tracking flood servicing events across business units, such as expiration and receipt of flood policies and the establishment of a letter log

to track the dates that notices were sent. After noting inconsistencies with the insurable value to clients, Clayton has suggested establishing written procedures outlining acceptable sources of insurable value and retaining evidence of insurable value within the loan file for structures and contents.

Often, coverage has not been obtained for contents as required for many commercial loans, so Clayton has recommended ensuring that the true intention of the parties is properly reflected in the language of the security instrument with regard to the collateral securing the loan, specifically for business assets/FF&E. Many client mortgages have included standardized general cross-collateralization clauses; however, flood coverage worksheets do not always include additional loan balances. Clayton has

recommended avoiding unintentional cross-collateralization language within the loan documents and ensuring the additional loan balances are included in the flood coverage calculation when cross-collateralization is intentional. Furthermore, Clayton has found that some clients only complete flood coverage

worksheets during MIRE events. As an additional control to ensure adequacy of coverage and safeguard against previous calculation errors, Clayton has proposed to clients to consider completing new flood coverage worksheets during key servicing events as needed through servicing of a loan.

### **Measure Performance, Validate Compliance and Identify Risk**

Clayton Servicing Oversight puts investors and servicing operations in a position to find potential problems and remediate them before internal or regulatory audits do.

Providing support when clients' internal resources are limited, the Clayton Servicing Oversight team prepares regulatory audits or performs deep dives into specific topics through loan-level testing or operational assessments of servicers and vendors. Clayton Servicing Oversight can also provide continuous portfolio monitoring to provide transparency into the performance of all or specific loan pools.

### **Our Servicing Oversight Solutions**

Loan-level Targeted Compliance Testing

Portfolio Monitoring

Operational Assessment



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