

October 2, 2014

**MEMORANDUM TO:** Board of Directors

**FROM:**

Mark Pearce

Director, Division of Depositor and Consumer Protection



**SUBJECT:**

Joint Notice of Proposed Rulemaking for the Purpose of Implementing the Escrow Requirements of the Homeowner Flood Insurance Affordability Act

### Summary of Recommendation

Staff recommends that the FDIC's Board of Directors approve and authorize the attached Notice of Proposed Rulemaking, entitled *Loans in Areas Having Special Flood Hazards* (NPR) for publication in the *Federal Register*, for a 60-day comment period. The NPR would implement certain provisions set forth in the Homeowner Flood Insurance Affordability Act of 2014 (the HFIAA)<sup>1</sup> regarding escrow requirements. The proposed regulation would amend Part 339 of Title 12 of the Code of Federal Regulations.

If approved, the NPR would be issued jointly by the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit Union Administration, and the Farm Credit Administration (collectively, the "Agencies").

### Background

BW Act: The Biggert Waters Flood Insurance Reform Act of 2012 (the BW Act) amended the Flood Disaster Protection Act of 1973<sup>2</sup> (the FDPA) and revised requirements under the National Flood Insurance Program (NFIP), the national flood protection and relief program administered by the Federal Emergency Management Agency (FEMA). Some of these revisions were effective immediately upon enactment. Other revisions require rulemaking to be implemented.

Among other requirements, the BW Act required the Agencies to direct that all premiums and fees for flood insurance for residential improved real estate or a mobile home be paid to the regulated lending institution or servicer for any loan secured by the improved real estate or mobile home with the same frequency as payments on the loan are made for the duration of the loan. The Act provided an exemption from this escrow requirement for institutions with assets of less than \$1 billion which, as of July 6, 2012 (the date of the BW Act's enactment), were not required by Federal or state law to escrow taxes or insurance for the term of the loan and did not have a policy to require escrow of taxes and insurance. The provision would have applied to any mortgage outstanding or entered into on or after July 6, 2014.

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<sup>1</sup> Pub. L. 113-89, 128 Stat. 1020 (2014).

<sup>2</sup> Pub. L. 93-234, 87 Stat. 975 (1973)

HFIAA: Pursuant to the BW Act, the Agencies issued a notice of proposed rulemaking (the BW Act NPR)<sup>3</sup> on October 30, 2013. On March 21, 2014, the President signed into law the HFIAA, which amended some of the changes made by the BW Act to the FDPA. Among these changes are amendments relating to the escrow requirement. Specifically, the HFIAA:

- Requires that escrowing of flood insurance premiums and fees be implemented on a “tripwire” approach, where a lender would only have to determine if it needs to escrow flood insurance premiums upon the origination, extension, renewal, refinance, or increase of a loan on or after January 1, 2016.
- Requires lenders to offer and make available an escrow option to borrowers with outstanding loans who are not required to escrow on or after January 1, 2016.
- Creates additional exceptions to the escrow requirement.

Note that the HFIAA escrow amendments will not supersede current escrow requirements under federal flood insurance legislation during the period from July 6, 2012, to December 31, 2015. Therefore, the escrow requirements in effect on July 5, 2012, the day before the BW Act was enacted, will continue to apply until December 31, 2015.

In addition, the HFIAA specified that flood insurance is not required for detached structures with respect to mortgage loans secured by residential property.

### Summary of the HFIAA NPR

Escrow Requirement: Consistent with the HFIAA, the NPR generally would require regulated lending institutions, or servicers acting on their behalf, to escrow premiums and fees for flood insurance for any designated loans secured by residential improved real estate or a mobile home that is originated, increased, extended, refinanced or renewed on or after January 1, 2016.<sup>4</sup> Except as may be required under applicable State law, a regulated lending institution would not be required to escrow if it has total assets of less than \$1 billion and, as of the date of enactment of the BW Act, was not required by Federal or State law to escrow taxes or insurance for the term of the loan and did not have a policy of requiring escrow of taxes and insurance (the “small lender exception”). The NPR would implement this exception substantially as set forth in the statute and the BW Act NPR. Furthermore, consistent with the BW Act NPR, the NPR would provide guidance for regulated lending institutions that have a change in status and no longer qualify for the exception.

The NPR would also implement the following additional exceptions from the escrow requirement mandated by the HFIAA:

- (i) loans in a subordinate position to a senior lien secured by the same property for which flood insurance is being provided;

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<sup>3</sup> See 78 F.R. 65108.

<sup>4</sup> The Agencies are proposing regulatory language that applies the requirements to loans “made, increased, extended, or renewed” to be consistent with the way these triggering events are referenced elsewhere in the regulation. The Agencies have long understood that the term “made” to encompass both a loan origination and a loan refinance.

- (ii) loans secured by residential improved real estate or a mobile home that is part of a condominium, cooperative, or other project development, provided certain conditions are met;
- (iii) loans that are extensions of credit for a business, commercial, or agricultural purpose;
- (iv) home equity lines of credit;
- (v) nonperforming loans; and
- (vi) loans with terms no longer than twelve months.

In addition, the NPR would implement the HFIAA requirement that regulated lending institutions offer and make available to a borrower the option to escrow flood insurance premiums and fees for loans that are outstanding as of January 1, 2016. The NPR would implement this provision with additional clarifications to provide more specific guidance to regulated lending institutions in administering this requirement, including a proposal to mail or deliver information about the option to borrowers by March 31, 2016, and requiring lenders to implement the escrow as soon as reasonably practicable after receiving a borrower's request to escrow. The NPR would also propose that regulated lending institutions that no longer qualify for the small lender exception also be required to offer and make available to a borrower the option to escrow flood insurance premiums and fees for outstanding loans.

Detached Structures: Consistent with the HFIAA, the Agencies' proposal would include a new exemption to the general mandatory flood insurance purchase requirement. Specifically, the proposed rule would provide that flood insurance is not required for any structure that is part of any residential property, but is detached from the primary residential structure of such property and does not serve as a residence. The Agencies solicit comment on whether additional clarification is needed, such as whether the exemption would apply if the detached structure secures a loan that is an extension of credit for a business, commercial, or agricultural purpose.

Sample Notice Forms and Clauses: The NPR would amend the current Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance, set forth as Appendix A in the FDIC's regulations, to add language concerning the escrow requirement. The proposal would also add an additional sample clause, Sample Clause for Option to Escrow for Outstanding Loans, as Appendix B to assist institutions in complying with the proposal's requirement to inform and make available to borrowers with outstanding loans the option to escrow flood insurance premiums and fees.

FDIC Integration of Savings Association Flood Insurance Regulations: In the BW Act NPR, the FDIC proposed to integrate its flood insurance regulations for State non-member banks and State savings associations. Specifically, the FDIC proposed to add language to 12 C.F.R. Part 339, its flood regulation for State non-member banks, to make it applicable to both State non-member banks and State savings associations and to remove its flood regulation for State savings associations, 12 C.F.R. Part 391 Subpart D. The NPR would apply to both State non-member banks and State savings associations. The NPR preamble explains that the FDIC will integrate its flood insurance rules for state savings associations into Part 339 prior to finalizing this NPR by means of a separate, individual agency rulemaking.

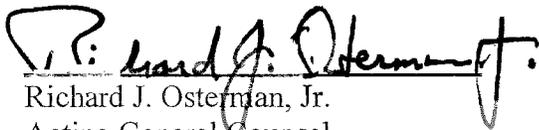
**Recommendation:**

Based on the foregoing, staff recommends the Board approve the attached Resolution to adopt and authorize the publication in the *Federal Register* the attached NPR for public comment.

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**CONCUR:**

A handwritten signature in black ink, appearing to read "Richard J. Osterman, Jr.", written over a horizontal line.

Richard J. Osterman, Jr.  
Acting General Counsel  
Legal Division

Attachments