

May 27, 2015

MEMORANDUM TO: Board of Directors

FROM:

Mark Pearce
Director, Division of Depositor and Consumer Protection



SUBJECT:

Final Rule to Implement Requirements of the Biggert-Waters Flood Insurance Reform Act and the Homeowner Flood Insurance Affordability Act

Summary of Recommendation

Staff recommends that the FDIC's Board of Directors approve the attached Final Rule (FR), entitled *Loans in Areas Having Special Flood Hazards*, for publication in the *Federal Register*. The FR would finalize two notices of proposed rulemaking issued in 2013 and 2014 to implement certain provisions set forth in the Biggert-Waters Flood Insurance Reform Act of 2012 (BW Act)¹ and subsequent amendments made by the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA)² regarding escrow requirements, detached structures, and force placement of flood insurance, but not certain private insurance provisions in the 2013 NPR which will be addressed in a later rulemaking. The regulation would amend Part 339 of Title 12 of the Code of Federal Regulations.

The FR is consistent with the BW Act and HFIAA, and it would implement the provisions substantially as set forth in the proposed rules. If approved, the FR 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

The BW Act amended the Flood Disaster Protection Act of 1973³ (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, including the force placement provision. Other revisions, such as the escrow requirements, require rulemaking to be implemented. Pursuant to the BW Act, the Agencies issued a notice of proposed rulemaking (BW Act NPR)⁴ 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, including the escrow requirements. Because the HFIAA made certain portions of the Agencies' BW Act NPR obsolete (*e.g.*, escrow

¹ Pub. L. 112-141, 126 Stat. 916 (2012).

² Pub. L. 113-89, 128 Stat. 1020 (2014).

³ Pub. L. 93-234, 87 Stat. 975 (1973)

⁴ Sec 78 F.R. 65108.

requirements) and added legal requirements (e.g., detached structures), the Agencies issued a second notice of proposed rulemaking on October 30, 2014 (HFIAA NPR).⁵ As a result, this FR would implement the escrow and detached structures provisions set forth in the HFIAA NPR and the force placement of flood insurance provisions in the BW Act NPR.

The significant differences between the BW Act and HFIAA statutory requirements are described below:

Escrow: 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 to be held in escrow. The BW Act provided an exemption from this escrow requirement for institutions with total assets of less than \$1 billion that, 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 of requiring escrow of taxes and insurance. The provision would have applied to any mortgage outstanding or entered into on or after July 6, 2014.

The HFIAA amendment 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. The statute also 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, and would create additional exceptions to the escrow requirement.⁶

Detached structures: While the BW Act did not address detached structures, the HFIAA specified that flood insurance is not required for detached structures with respect to mortgage loans secured by residential property. Specifically, it created a new exemption to the general mandatory flood insurance purchase requirements 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. This provision became effective immediately upon enactment of the HFIAA.

Force Placement: The BW Act amended federal flood insurance legislation to provide that the lender or servicer may charge the borrower for the cost of force placed flood insurance premiums and fees incurred by the lender or servicer for coverage beginning on the date on which flood insurance coverage lapsed. The BW Act also amended federal flood insurance legislation to require that the lender or servicer terminate force placed insurance and refund all premiums and related fees paid by the borrower for force placed insurance during any period in which both the borrower's flood insurance coverage and the force placed insurance coverage overlapped. These provisions were unaffected by the HFIAA.

⁵ See 79 F.R. 64518.

⁶ 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.

Summary of the BW Act and HFIAA NPR Provisions Addressed in the Final Rule

Eighty-one written comments to the BW Act NPR and fifty-two written comments to the HFIAA NPR were received. Comments were received for both proposals from a wide range of respondents: financial institutions, including banks, credit unions and farm credit institutions; various trade associations, including bankers' trade associations, credit union trade associations, home building and realtor trade associations, and a flood hazard determination trade association; the insurance industry, including insurance companies, trade associations, and brokers; individuals; public interest/consumer advocates; state insurance regulators and a municipal government. In addition to written comments, outreach was also conducted with several stakeholders in the flood insurance community, including teleconferences with state insurance regulators, staff of the National Association of Insurance Commissioners (NAIC) and FEMA staff.

Escrow: In accordance with the BW Act, the HFIAA amendments, and the HFIAA NPR, the FR requires regulated lending institutions, or servicers acting on their behalf, to escrow premiums and fees for flood insurance for any loans secured by residential improved real estate or a mobile home made, increased, extended, or renewed on or after January 1, 2016. In addition, the FR addresses the exemption for institutions with total assets of less than \$1 billion that, 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 of requiring escrow of taxes or insurance. The Agencies implement this exception in the final rule with some clarifications. In addition, the Agencies are adopting transition rules for regulated lending institutions that have a change in status and no longer qualify for this small-lender exception.

The FR also implements the following additional statutory exceptions from the escrow requirement, as amended by HFIAA and proposed by the Agencies:

- (i) loans that are in a subordinate position to a senior lien secured by the same property for which flood insurance is being provided;
- (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 primarily for a business, commercial, or agricultural purpose;
- (iv) home equity lines of credit;
- (v) nonperforming loans (a loan 90 or more days past due that remains nonperforming until permanently modified or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full); and
- (vi) loans with terms not longer than 12 months.

Finally, the FR implements the requirement that regulated lending institutions that are not exempt from the escrow requirement must offer and make available to a borrower the option to escrow flood insurance premiums and fees for loans that are not subject to the mandatory escrow requirement and are outstanding as of January 1, 2016. The FR is generally consistent with language proposed in the HFIAA NPR. In response to some commenters' suggestions, however,

regulated lending institutions will be given additional time – until June 30, 2016 – to mail or deliver information to borrowers about the option to escrow. The FR also adopts the proposal to require those regulated lending institutions that no longer qualify for the small lender exception to offer and make available to borrowers the option to escrow flood insurance premiums and fees.

Detached structures: The FR incorporates the new detached structures exemption to the mandatory flood insurance purchase requirement substantially as set forth in HFIAA and the HFIAA NPR. This exemption applies to any structure that is a part of a residential property but is detached from the primary residential structure and does not serve as a residence. The FR also clarifies what is considered “a structure that is part of a residential property,” “detached,” and “serve as a residence.” Specifically, the FR clarifies that:

- (i) “a structure that is part of a residential property” is a structure used primarily for personal, family, or household purposes, and not used primarily for agricultural, commercial, industrial, or other business purposes;
- (ii) a structure is “detached” from the primary residential structure if it is not joined by any structural connection to that structure; and
- (iii) “serve as a residence” shall be based upon the bank’s good faith determination that the structure is intended for use or actually used as a residence, which generally includes sleeping, bathroom, or kitchen facilities.

Force placement: The FR incorporates the force-placed flood insurance provisions consistent with the BW Act and BW Act NPR, which were unaffected by HFIAA. The FR: 1) amends the force-placement of flood insurance provisions to clarify that a lender or its servicer has the authority to charge a borrower for the cost of flood insurance coverage commencing on the date on which the borrower’s coverage lapsed or became insufficient; 2) stipulates the circumstances under which a lender or its servicer must terminate force-placed flood insurance coverage and refund payments to a borrower; and 3) sets forth the documentary evidence a lender must accept to confirm that a borrower has obtained an appropriate amount of flood insurance coverage.

Sample forms and notices: The FR includes new and revised sample notice forms and clauses to incorporate new borrower notice requirements under the BW Act. For example, the FR amends the current Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance, set forth as Appendix A in Part 339 of FDIC Regulations, to add language concerning the escrow requirement. Language is also included in Appendix A pertaining to the detached structures exemption.

The FR also includes an additional sample clause, Sample Clause for Option to Escrow for Outstanding Loans, as Appendix B to assist institutions in complying with the requirement to inform borrowers with outstanding loans about their option to escrow flood insurance premiums and fees.

Technical corrections: The FR will make needed technical corrections, e.g., all references to the head of FEMA as “Director” will be corrected to “Administrator.”

Recommendation

Staff recommends the Board approve the attached Resolution to adopt and authorize the publication in the *Federal Register* of the attached FR.

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CONCUR:

A handwritten signature in black ink, appearing to read 'Charles Yi', is written over a horizontal line.

Charles Yi
General Counsel
Legal Division

Attachments