

# Flood Insurance Reform: More Wading Through the Water(s)



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# Introduction & Agenda



- **Welcome!** 😊
- **Review amendments to rules governing flood insurance**
  - Biggert-Waters Flood Insurance Reform Act of 2012
  - Homeowner Flood Insurance Affordability Act of 2014
  - Resulting proposed rules

# Introduction & Agenda (cont'd)



- **Discuss June 2015 Final Rule** 
  - Overview of applicable effective dates
  - Detached structure exemption
  - Force-placement requirements
  - Escrow rules
  - Revised Special Flood Hazard Notice



# How Did We Get Here?

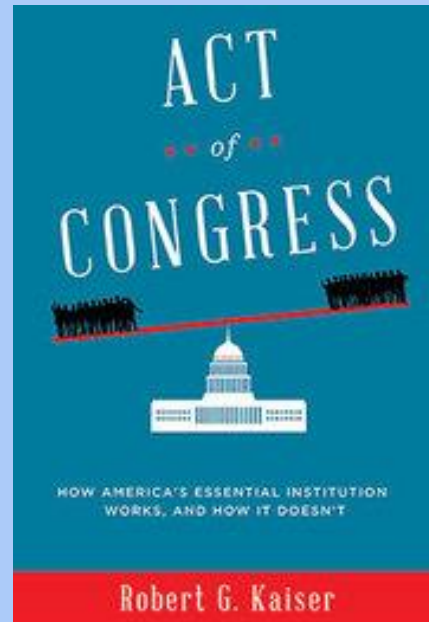


- **Biggert-Waters (BW-12) – July 6, 2012**
  - First major amendment to National Flood Insurance Program (NFIP) in years
  - Resulted in October 2013 Proposed Rule
    - ✦ Mandatory escrow for flood insurance premiums
    - ✦ Requirement to accept private flood insurance
    - ✦ New force-placement provisions
    - ✦ Revised Special Flood Hazard Notice

# Biggert-Waters Act



- **BW-12 did more than just result in the October 2013 Proposed Rule**



# BW-12 Increased CMPs



- **Maximum civil money penalty (CMP) increased to \$2,000 per violation**
  - Annual cap on penalties removed
  - Effective upon BW-12 enactment (7/6/12)



# Required Updates to RESPA Booklet



- **BW-12 revised Section 5(b) of RESPA (contents of RESPA booklet)**
  - Adds notice advising borrowers of the availability of flood insurance
  - Informs borrowers that insurance is available from the NFIP or from a private insurance company

# Updates to RESPA Booklet (cont'd)



- **“Your Home Loan Toolkit”**
  - CFPB has already updated booklet to provide required language





## Updates to RESPA Booklet (cont'd)

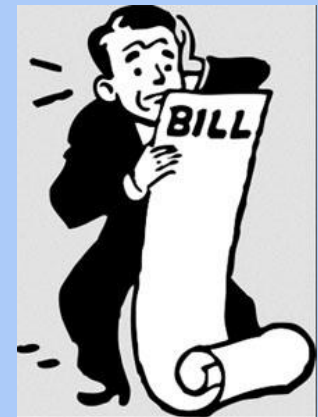


- ***“Although you may not be required to maintain flood insurance on all structures, you may still wish to do so, and your mortgage lender may still require you to do so to protect the collateral securing the mortgage. If you choose to not maintain flood insurance on a structure, and it floods, you are responsible for all flood losses relating to that structure.”***

# How Did We Get Here (cont'd)



- **Homeowner Flood Insurance Affordability Act of 2014 (HFIAA)**
  - Resulted in October 2014 Proposed Rule
    - ✦ Sought to make escrow requirements under BW12 consistent with HFIAA
    - ✦ Addressed detached structure exemption



# How Did We Get Here (cont'd)



- **June 2015 Final Rule**
  - Clarifies detached structure exemption
  - Implements mandatory escrow requirements
  - Amends force-placement provisions
  - Provides new Special Flood Hazard Area (SFHA) Notice
  - Agencies will address private flood insurance requirements in a separate rulemaking

# Final Rule Effective Dates



- **October 1, 2015:**

- Detached structure exemption
  - ✦ March 21, 2014
- Force-placement requirements
  - ✦ July 6, 2012



- **Note:**

- ***Both items above are already in effect!***
- Guidance offered from Final Rule could likely be followed now

# Final Rule Effective Dates (cont'd)



- **January 1, 2016:**
  - Escrow requirements
  - Revised Special Flood Hazard Notice
- **TBA:**
  - Private flood insurance requirements



# Flood Insurance Coverage



# Coverage – Designated Loans



- **Applies to loan secured by improved real property in a SFHA**
  - Building or mobilehome
- **“Improved real property”**
  - 2 or more rigid walls
  - Fully secured roof
  - Affixed to a permanent site
- **Tip: Flood Insurance Manual includes list of “ineligible risks” (GR 7)**

# Coverage (cont'd)



- **Commercial, business, agricultural and residential loans covered**
  - Whether open-end or closed-end
  - Regardless of lien priority
- **Loans secured by vacant land not covered**
- **Abundance-of-caution collateral covered!**

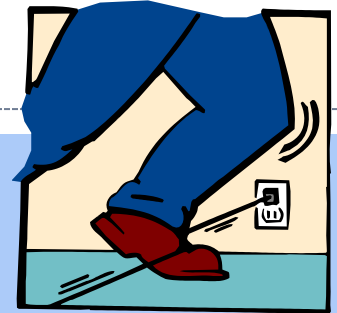


# Lender Requirements



- **When lender makes, increases, renews or extends (MIRE) a loan:**
  - Determine flood zone (A or V?)
  - Notice to borrower (10-day notice) and servicer
  - Require flood insurance
  - Escrow flood insurance premiums (if applicable)
  - Force place if necessary

# Tripwires



- **MIRE – most common tripwires for compliance with flood insurance requirements**
- **Any situation that alerts lender to change in circumstances**
  - Known map change
- **Loan purchase or transfer between regulated lenders/servicers = NOT a tripwire**
- **FNMA/FMAC purchase = tripwire!**

# NFIP Limits

<b>Building Coverage</b>	<b>Regular Program</b>	<b>Emergency Program</b>
Residential (1-4 units)	\$250,000	\$35,000
Other residential (5+ units)	<b>\$500,000</b>	\$100,000
Nonresidential	\$500,000	\$100,000
Condominium master policies	\$250,000 x number of units	
<b>Contents Coverage</b>	<b>Regular Program</b>	<b>Emergency Program</b>
Residential	\$100,000	\$10,000
Other residential	\$100,000	\$10,000
Nonresidential	\$500,000	\$100,000

# Exemptions From Flood Coverage



- **Prior to HFIAA, only two limited exemptions from flood insurance requirements**
  - 1) State-owned property
    - ✦ Under self-insurance policy satisfactory to FEMA
    - ✦ California does not qualify!
  - 2) Short-term loans of \$5,000 or less
    - ✦ Loans with principal balance of \$5,000 or less and
    - ✦ A term of one year or less

# Detached Structure Exemption



- **New Exemption added by HFIAA**
  - March 21, 2014
- **June 2015 Final Rule provides additional clarification**
- **Effective October 1, 2015**

# Detached Structure Exemption



- **Applies to:**

- *“Any structure that is part of any residential property, but is detached from the primary residential structure and does not serve as a residence”*
  - ✦ “Primary residential structure” not defined
  - ✦ “Detached” means the structure stands alone
  - ✦ “Serves as a residence” – look to intended use
    - No duty to monitor use, unless MIRE occurs

# Important Definitions



- **“Structure that is part of a residential property”**
  - A structure used primarily for personal, family or household purposes
  - And not used primarily for agricultural, commercial, industrial, or other business purposes
- **Loan purpose is immaterial!**

# Detached Structure Exemption



- **Supplementary Information adds that the exemption:**
  - *“Should be available in connection with consumer loans, as well as those made for business, commercial or agricultural purposes, if the loan is secured by a residence.”*



# Detached Structure Exemption



- **Structures likely impacted:**
  - Detached garages
  - Sheds (if eligible structures)
  - Other detached structures



# Detached Structure Exemption



- **Detached structures used primarily for commercial, agricultural or business purposes not eligible!!!**
- **According to Agencies, expands exemption too far**
- **Mixed-use structures:**
  - Eligible if primarily residential purpose
  - Structure must be part of residential property

# Detached Structure Exemption



- **Also eligible for exemption:**

- Multi-family structures (5+)
- Renter-occupied structures

- **TIP:**

- Don't confuse loan purpose with purpose of the detached structure!
- Focus is on use of structure!



# Detached Structure Exemption



- Lender not required to exempt structure from coverage
- Lender may require insurance up to RCV of structure
- Practical issues to consider:
  - Notice?
  - Acknowledgment?
  - Neither?
  - Both?



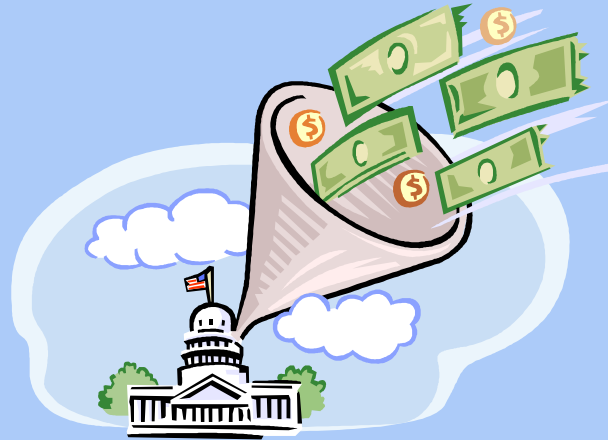
# Escrow Requirements



# Current Escrow Requirement



- **Lender must escrow for flood insurance premiums on residential structures if it requires escrowing of property taxes and hazard insurance**



# New Escrow Requirement



- Lender must escrow flood insurance premiums on residential structures regardless of whether lender requires escrowing of property taxes and hazard insurance



# New Escrow Requirement



- **Initially, the escrow requirement seemed to have very broad impact**
- **HFIAA amended the proposed October 2013 flood regulations in relation to escrow requirements**
- **New escrow requirement effective January 1, 2016 (per HFIAA and June 2015 Final Rule)**



# New Escrow Requirement

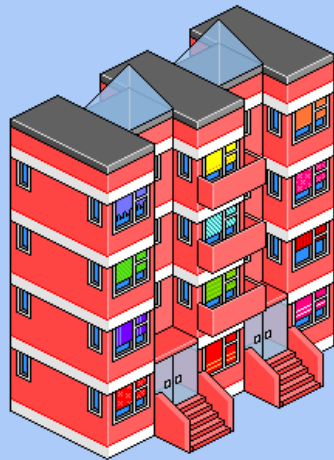


- A lender must escrow all premiums and fees for required flood insurance
- Applies to consumer purpose loans secured by residential improved real estate or a mobile home
- That are MIREed on or after January 1, 2016
- Payable in same frequency as payments on loan are made for loan term

# New Escrow Requirement



- **Not limited to SFRs**
  - Includes multi-family dwellings (5+)
  - Includes mixed-use properties too
    - ✦ Look to primary use of property
  - Examples



# Trigger for Escrow Account



- **MIRE on or after Jan 1, 2016!**
  - Application might be taken prior to Jan 1, 2016
  - But loan might close after Jan 1, 2016
  - Loans in this situation are COVERED!!!
- **Map changes are NOT triggering events!**



# Applicability of RESPA



- **Flood insurance premiums must be deposited into escrow account**
- **Escrow account subject to RESPA Section 10 (if loan covered by RESPA)**
  - Limits amount held in escrow
  - Requires escrow account statements

# Exceptions to Escrow Requirement



- **Added by HFIAA, confirmed in Final Rule**
  - Business-purpose loans (look to Reg Z)
  - Subordinate lien loans (if flood insurance provided for senior lien at origination)
  - Condos and coops (if flood insurance paid by HOA or coop)
  - HELOCs
  - Business-purpose loans secured by a residence
  - Loans with a term of 12 months or less
  - Nonperforming loans (90+ days past due)

# Exceptions to Escrow Requirement



- **What if the loan status changes?**
  - Ex: Senior lien paid off or loan begins to perform
  - No duty to monitor loan status to see if escrow requirement kicks in at later date
  - *HOWEVER, if lender determines at any time that an exception no longer applies then it must require escrow account!*
    - ✦ **This means lender should include flood insurance disclosure notice in all SFHA Notices! (More on this later!)**

# Small Lender Exception



- **Exception for small institutions**
  - Assets <\$1 billion as of December 31 of either of two prior calendar years
  - On or before July 6, 2012, was not required to escrow for taxes or insurance for any residential loan; and
  - On or before July 6, 2012 did not require escrow for taxes and insurance for any residential loan
- **Must meet all three conditions!**

# Small Lender Exception (cont'd)



- **Exception based on asset size**
- **What if lender loses exception because asset size exceeds \$1 billion for 2 consecutive years?**
  - Lender now subject to escrow requirements
  - Must follow transition rules
  - Have 6 months to develop escrow program



# Transition Rules - Examples



- **ABC Bank is a small lender at year-end for 2014 and 2015**
  - ABC Bank need not comply with escrow rules come January 1, 2016
- **At the end of 2016, ABC Bank has assets over \$1 billion**
  - ABC Bank loses small lender exception and must comply with escrow rules



# Transition Rules - Examples (cont'd)



- **ABC Bank has 6 months from Dec 31, 2016 to get escrow program in place**
- **Thus, ABC Bank must escrow flood insurance premiums for all loans it MIREs on or after July 1, 2017**



# Don't Forget the Escrow Notice!



- **If a lender is no longer covered by the small lender exception, it must send to customer the Flood Escrow Disclosure when it MIREs loans on or after July 1, 2017**
  - If you already included the Flood Escrow Disclosure in your SFHA Notice, no action is required

# Transition Rules – Examples (cont'd)



- **Suppose at the end of 2017, ABC Bank's assets have fallen below \$1 billion**
- **ABC Bank is eligible, once again, for the small lender exception**
- **However, the Agencies doubt a lender would abandon its escrow program at that point**
  - Burden to develop program, confused customers

# Flood Escrow Disclosure



- **Must be provided when MIRE happens**
- **Provide **with or in** the SFHA Notice**
- **Informs borrower that lender may be required to escrow all flood insurance premiums and fees**
- **Effective January 1, 2016**
- **Model language provided – Appendix A**

# New Flood Escrow Disclosure – Model Clause



- ***Federal law may require a lender to escrow all premiums and fees for flood insurance that covers any residential building or mobile home securing a loan that is located in an area with special flood hazards. If your lender notifies you that an escrow account is required for your loan, then you must pay for flood insurance premiums and fees to the lender with the same frequency as you make loan payments for the duration of your loan. These premiums and fees will be deposited in the escrow account, which will be used to pay the flood insurance provider.***

# Option to Escrow



- **Effective January 1, 2016**
- **Lender must provide borrowers with the option of escrowing flood insurance premiums**
- **Applies to loans:**
  - Outstanding on Jan 1 ,2016; or
  - Outstanding on July 1 of first calendar year in which lender is no longer a “small lender”

# Option to Escrow (cont'd)



- **Exceptions:**

- Loan qualifies for loan-related exception
- Lender qualifies for small lender exception
- Borrower is already escrowing for flood





# Option to Escrow (cont'd)



- **Must notify borrower of “option” in writing or electronically by:**
  - June 30, 2016; or
  - September 30, 2016 (for lenders that lost small lender exception)
- **Notice required (Appendix B)**
  - Additional explanation may be added to notice
- **Separate or with other disclosure**
  - For example, closed-end periodic statements

# Option to Escrow (cont'd)



- **If borrower exercises “option,” lender must begin escrowing as soon as reasonably practicable**



# Forced-Placement Provisions



# Force-Placed Insurance



- **General force-placement requirements remain unchanged**
  - Determine if structure securing loan is in SFHA
  - Check if structure is not covered or coverage is inadequate
  - Must notify borrower and require insurance
  - Borrower has 45 days to obtain insurance
  - If evidence of insurance not provided, lender must force place coverage and may charge borrower for cost of premiums and fees

# Force-Placed Insurance (cont'd)



- **BW-12/June 2015 Final Rule allow lender to begin charging borrowers for premiums and fees incurred on date flood insurance coverage lapsed**
  - Per agency letter, effective when BW-12 enacted
  - “Lapsed” = expiration date or date policy cancelled



# Force-Placed Insurance (cont'd)



- **Borrower still has 45 days to provide proof of coverage**
- **Lender may wish to hold off on collecting force-placed premium until 45-day period has expired**
  - Avoids burden of refunding consumer
  - Is “waiting to collect” a requirement?



# Force-Placed Insurance (cont'd)



- **Must terminate overlapping policy and refund within 30 days**
  - Ex: If borrower provides evidence of coverage on or after the 46<sup>th</sup> day, lender needs to terminate policy and refund overlapping premium
- **Evidence of coverage**
  - Insurance declarations page
  - Is certificate of insurance acceptable?

# Revised Special Flood Hazard Notice



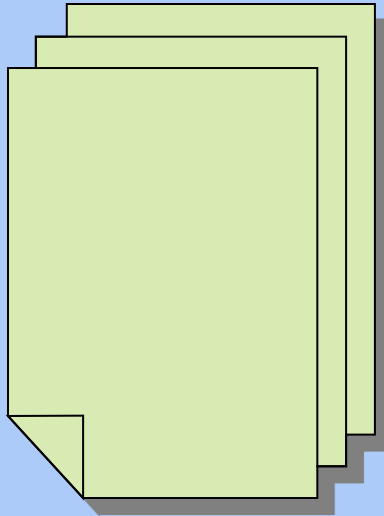


# Revisions to SFHA Notice



- **Effective January 1, 2016**
  - “Availability of Flood Insurance” disclosure
    - ✦ Same as required in RESPA booklet
  - Enhanced “Private Flood Insurance” disclosure

# Private Flood Insurance



# Private Flood Insurance – Current Rule



- **FEMA's former Guidelines provided six criteria for determining whether private flood insurance can substitute for or supplement NFIP insurance**



# Six Criteria – Current Rule



- **1) Insurer licensed or admitted to do business in jurisdiction where building is located**
- **2) For non-residential properties, insurer needs to be recognized as surplus lines insurer**
- **3) 45-day advance notice of cancellation or non-renewal**

# Six Criteria – Current Rule



- **4) Guarantee that flood coverage is as least as broad under SFIP**
- **5) Strength of mortgage interest clause**
- **6) Policy gives insured the right to file suite within one year of claim denial**

# Private Flood Insurance Policy – Proposed Rule



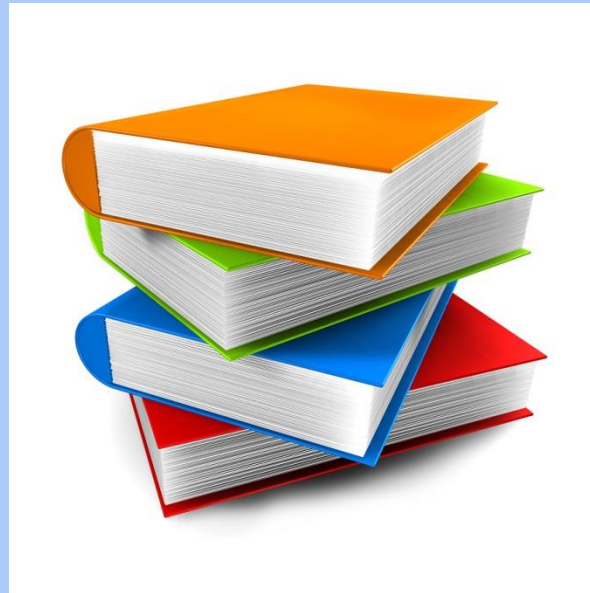
- **October 2013 proposal – new definition of private flood insurance**
- **Similar to 6 criteria under current rules**
- **June 2015 Final Rule states private flood regulations will be addressed in separate rulemaking**
- **In the meantime, continue referring to FEMA's 6 criteria**

# Notice to Borrowers



- **Per BW-12, lender must notify borrower that private flood insurance with same level of coverage as NFIP policy is available**
- **Lender must encourage borrowers to compare NFIP and private policies**
- **Proposal to include this notice in the “10-day notice”**

# Flood Insurance Resources





# Flood Insurance Resources



- **Existing agency regulations remain the primary resource**
  - Don't forget BW-12, HFIAA and June 2015 Final Rule!
- **Mandatory Purchase Guidelines**
  - Officially rescinded in February 2013
  - FEMA: Instructs lenders to “consult their respective regulatory agency for information regarding compliance with the mandatory purchase requirements”

# Flood Insurance Resources (cont'd)

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- **Interagency Q&As Regarding Flood Insurance**
  - Remain a good resource for lenders
- **FEMA Flood Insurance Manual**
  - Updated October 1, 2014
  - General Rules section helpful



# Question & Answer Session

*(time permitting)*



# Speaker Contact Information



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