Flood Rule Changes – 2016

Escrow, Detached Structure Exemption, Force-placement

Fact Sheet

Sterling COMPLIANCE

EFFECTIVE DATES: Mandatory escrow and revised notice provisions had a January 1, 2016 effective date, while the other clarifications became effective October 1, 2015.

KEY HIGHLIGHTS

- **Detached Structure Exemption**: Establishes new exemption to the mandatory flood insurance purchase requirement for 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
- **Mandatory Escrow**: Requires lending institutions and servicers to escrow premiums and fees for flood insurance for any loan secured by residential improved real estate or a mobile home that is made, increased, extended or renewed **on or after January 1, 2016**
  - Required lending institutions not exempted from the escrow requirement to 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**.
  - Includes new and revised sample notice forms and clauses
- **Force-placemen**t: Clarifies the timing in which a lending institution or servicer may charge the borrower for force-placed insurance; the circumstances under which force-placed insurance must be terminated and refunds made; and, documentary evidence sufficient to demonstrate that a borrower has flood insurance coverage

CLARIFICATION ON DETACHED STRUCTURES[1]

- Detached structures used for commercial, agricultural or other business purpose should be protected adequately by flood insurance as collateral given their value to the borrower and lender (i.e. these properties are NOT covered by the detached structure provision)
- The final rule clarifies that the phrase, "a structure that is part of a residential property" refers to a structure used primarily for personal, family or household purposes
- "Detached" has been defined as standing alone (i.e. it is not joined by any structural connection to the residential structure)
- To be exempt from the mandatory flood insurance purchase requirement, the detached structure also may not "serve as a residence" (i.e. you must focus on the *intended use* of the structure)

ESCROWING FOR FLOOD INSURANCE PREMIUMS & FEES

- The stature applies to loans that experience a triggering event (e.g. made, increased, extended or renewed) **on or after January 1, 2016**
- A map change does NOT constitute a triggering event and you will not be required to escrow flood insurance premiums and fees based solely on that change

[1] Initially became effective upon the enactment of the HFIAA on March 21, 2014

EXCEPTIONS TO ESCROW REQUIREMENT

What does it mean to have a policy of uniformly and consistently escrowing taxes and insurance?

The final rule stops short of providing granular clarification where this is concerned. Several commenters proposed a bright line test (e.g. 100 mortgages per year or 5% of the portfolio) to determine whether an institution has such an escrow policy. The Agencies did not believe these limits would be consistent with the FDPA and declined to adopt such standards.

It is our interpretation that any pattern or practice of escrowing for taxes and insurance, whether required by your institution or not, would constitute an informal policy of requiring escrow and you would not be exempt from the mandatory escrow requirements. The premise of the Small Lender Exception is to not place undue financial or operational burden on institutions who have not

- Institutions of less than $1B in assets, as of July 6, 2012 that were not required by Federal or State law to escrow taxes or insurance for the term of a loan and did not have a policy of uniformly and consistently escrowing taxes and insurance (i.e. Small Lender Exception)
- Loans in a subordinate lien position to a senior lien secured by the same property for which flood insurance is being provided
- Loans secured by residential improved real estate or a mobile home that is part of a condominium, cooperative or other project development, as long as the condo, coop or other project development is covered by a flood insurance policy that: meets the mandatory flood insurance purchase requirement; is provided by the condo association, coop, homeowners association or other applicable group; and, the premium for which is paid by the association as a common expense.
- Loans that are extensions of credit primarily for a business, commercial or agricultural purpose
- Home equity lines of credit
- Non-performing loans (i.e. a loan that is 90 or more days past due and remains non-performing until it is permanently modified or until the entire amount past due, including principal, accrued interest and penalty interest incurred as the result of the past due status, is collected or otherwise discharged in full)
- Loans with terms not longer than 12 months; if a loan of 12 months or less is extended or renewed for an additional term of 12 months or less, the exception

would continue to apply because the extension/renewal is not considered to be a triggering event

Note: When you determine that an exemption no longer applies, you must require escrow of flood insurance premiums and fees.

Force-Placed Insurance Clarifications[2]

- You may charge the borrower for the cost of premiums and fees incurred for coverage beginning on the date on which the borrower's flood insurance coverage lapsed or did not provide a sufficient coverage amount (i.e. the date on which the flood insurance coverage lapses is the **expiration date provided by the policy or the date the flood insurance policy is cancelled**)
- You must still send your 45-day notice following the date of lapse of identification of insufficient coverage, but you may purchase force-placed insurance immediately after the borrower's original policy lapses
- You may charge the borrower for the cost of premiums and fees incurred for coverage beginning on the date on which flood insurance lapsed or did not provide a sufficient coverage amount
- Most force-placed insurance policies are private flood insurance policies rather than policies written under the MPPP administered by FEMA; private force-placed flood insurance policies generally do not have a 30-day waiting period and would allow you to force-place insurance effective immediately
- As a practical matter, you may decide to wait until the 45-day notice period has expired to collect premiums for coverage dating back to the date the force-placed policy was purchased to avoid the administrative burden of having to refund the borrower's premium for any period of overlapping coverage
- ***Important Note***: If purchasing a new policy is necessary to force-place insurance upon discovery of insufficient coverage, you may not charge back to the date of lapse or insufficient coverage because the policy did not provide coverage for the

[2] Initially became effective upon enactment of the BW Act on July 6, 2012

borrower prior to purchase (i.e. if insurance was not sufficient or in place and the deficiency was not initially identified by your monitoring efforts).

- Within 30 days of receipt of a confirmation of a borrower's existing flood insurance coverage, you are required to notify the insurer to terminate any force-placed insurance and refund all premiums paid by the borrower for any insurance purchased for any periods of overlapping coverage.
- You must accept from the borrower an insurance policy declarations page that includes the existing flood insurance policy number and the identity of, and contact information for, the insurance company or its agent; any further inquiry regarding the borrower's policy along with the termination and refund of premiums for the overlap period must be completed within the 30-day period following receipt of confirmation of a borrower's existing flood insurance coverage

NOTICE OF SPECIAL FLOOD HAZARDS | NEW SECTION

Section 100239 of BWA added a new section to the Notice of Special Flood Hazard Areas, which requires you to disclose to the borrower that:

- Flood insurance is available from private insurance companies that issue SFIPs on behalf of the NFIP or directly from the NFIP;
- Flood insurance that provides the same level of coverage as an SFIP under the NFIP may be available from a private insurance company that issues policies on behalf of the company; and,
- The borrower is encouraged to compare the flood insurance coverage, deductibles, exclusions, conditions and premiums associated with flood insurance issued on behalf of the NFIP and policies issued on behalf of private insurance companies. Inquiries regarding the availability, cost and comparisons of flood insurance should be directed to an insurance agent.

The effective date of this provision coincides with the **January 1, 2016** effective date for escrow provisions. **Model language has been provided within Appendix A of the**

final rule.

SAMPLE FORMS AND CLAUSES

- **Appendix A to Part 339 | Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance** is located on Pages 109-110 of the Final Rule
- **Appendix B to Part 339 | Sample Clause for Option to Escrow for Outstanding Loans** is located on Pages 110-111 of the Final Rule