
Amendments Proposed to Flood Insurance Regulations

November 7, 2014

Federal banking agencies have proposed amendments to flood insurance regulations that will (1) change the requirements for escrowing flood insurance premiums, and (2) incorporate a statutory provision that exempts certain detached structures from the mandatory flood insurance purchase requirement. These proposed amendments are discussed below.

Flood Insurance Escrow Requirements

Under current regulations, a bank or a credit union is generally required to escrow funds for flood insurance premiums if it escrows for taxes, insurance premiums, fees, or any other charges for a loan secured by residential improved real estate located in a special flood hazard area. Pursuant to legislation adopted in 2012 and subsequently modified earlier this year, the escrow requirement was expanded to generally require the escrow of flood insurance premiums even if the lender does not otherwise escrow for taxes, insurance or other charges. The proposed regulatory amendments implement this new requirement.

Under the proposed amendments, a bank or credit union (or a servicer acting on the institution's behalf) must require the escrow of flood insurance premiums for any loan secured by residential improved real estate or a mobile home located in a special flood hazard area that is made, increased, extended, or renewed on or after January 1, 2016, payable with the same frequency as payments on the loan are made for the duration of the loan. A specific form of notice to the borrower has been included in the proposal.

The proposed amendments provide a number of exceptions to the escrow requirement, as well as a small lender exemption. Pursuant to the proposed exceptions, escrowing of flood insurance premiums would not be required:

- For a loan primarily for business, commercial, or agricultural purposes;
- For a loan in a subordinate position to a senior lien secured by the same residential property for which the borrower has obtained the required flood insurance;
- If the property is already covered by a policy that otherwise meets the flood insurance requirements, such policy is provided by a condominium association, cooperative, homeowners association, or other applicable group, and the premium is paid by the condominium association, cooperative, homeowners association, or other applicable group as a common expense;
- For a home equity line of credit;
- If the loan is a nonperforming loan that is 90 or more days past due; or

- If the loan has a term of 12 months or less.

Pursuant to the proposed small lender exemption, the escrow requirements would not apply to an institution that (a) has total assets of less than \$1 billion, and (b) was, on or before July 6, 2012, not required under federal or state law to escrow for taxes, insurance, fees, or other charges, and did not have a policy of uniformly requiring the escrow of such amounts.

The proposed amendments also impose an additional requirement on banks and credit unions (and servicers acting on their behalf) with respect to loans outstanding on January 1, 2016 which are secured by residential improved real estate located in a special flood hazard area. The bank or credit union (or servicer) would have to offer and make available to a borrower on such a loan the option to escrow for flood insurance premiums. (If such a loan is increased, extended, or renewed on or after January 1, 2016, then this escrow requirement is mandatory; the availability of the option to escrow is for those loans in place as of January 1, 2016 where there has been no increase, extension, or renewal.) The proposed amendments include a proposed form of notice that lenders or servicers must send to these borrowers advising them of the availability of the escrow option.

Exemption for Certain Detached Structures

Federal legislation that took effect on March 21, 2014, excludes certain detached structures from the mandatory flood insurance requirements on residential loans. That exclusion is currently effective, and the proposed regulatory amendments are intended to confirm the federal flood regulations to the new statutory requirement.

Under this exemption, flood insurance is not required for any structure that is part of any residential property but is detached from the primary residential structure and does not serve as a residence. This exemption is intended to exclude relatively low-value structures, such as detached sheds and garages, from mandatory flood insurance coverage if such structures secure a loan in a special flood hazard area. The proposal states, however, that a lender may still choose to require flood insurance for these types of detached structures from a business standpoint even if federal law and regulations do not require insurance for such structures.

Comments; Effective Dates

This proposal was issued jointly by the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the National Credit Union Administration. Comments on these amendments must be received by regulators on or before December 29, 2014.

The final version of the new escrow rules will take effect for loans originated, refinanced, increased, extended, or renewed on or after January 1, 2016. The statutory change exempting certain detached structures from the mandatory flood insurance purchase requirement took effect on March 21, 2014; the regulatory amendment currently pending is to confirm the flood insurance regulations to the statutory change.

If you have any questions regarding these proposed amendments or flood insurance in general, please feel free to contact Joseph D. Simon at 516-357-3710 or via email at jsimon@cullenanddykman.com or Elizabeth A. Murphy at 516-296-9154 or via email at emurphy@cullenanddykman.com.

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