



FLOOD INSURANCE UPDATE

Last Revised: May 30, 2014

As most lenders know, the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) made numerous changes to the world of flood insurance. What are currently causing lenders the most concern are the effective dates of the following Biggert-Waters provisions – (1) the increase in the NFIP maximum for residential buildings with five or more dwelling units; (2) the changes to the amounts of the NFIP deductibles; (3) the revised requirement to escrow flood insurance premiums; (4) the new requirement to accept “private flood insurance”; (5) the revised requirement to force place insurance; and (6) the revisions to the Special Information Booklet. Also, the Homeowner Flood Insurance Affordability Act of 2014 (2014 Flood Reform Act), which was signed into law in March 2014, added a new exemption to the mandatory purchase of flood insurance requirements, the effective date of which has also been a concern of lenders. Each of these are discussed in turn below.

The bottom line is that the increase in the NFIP maximum for residential buildings with five or more dwelling units and the changes to the NFIP deductibles will be effective June 1, 2014, the revised requirement to escrow flood insurance premiums will be effective January 1, 2016 (yes, 2016), and because we are awaiting for the agencies to finalize their proposal to amend the flood insurance regulations and the CFPB to revise the Special Information Booklet, it is not clear when the remaining provisions will be effective.

NEW – Increase in the NFIP Maximum for Other Residential Buildings

Among other things, Biggert-Waters required FEMA to increase the NFIP maximum coverage limit from \$250,000 to \$500,000 per residential building with five or more dwelling units (what FEMA refers to as “Other Residential Buildings”). To implement this change as well as other Biggert-Waters-mandated changes, FEMA issued memorandum W-13070. According to the memorandum, the new \$500,000 Other Residential Building NFIP maximum coverage will apply to new policies, renewals or change endorsements that are effective on or after June 1, 2014.

On May 30, 2014, the agencies (FDIC, FRB, OCC and NCUA), as well as the Farm Credit Administration, issued an interagency statement regarding this increase. Refer to FDIC FIL-28-2014. More specifically, the interagency statement addresses the effective date of the increase in coverage for Other Residential Buildings and what is expected of financial institutions in light of the increase. The statement confirms that “the new coverage limits are available for new policies, policy renewals, or existing policies with change endorsements that are effective on or after June 1, 2014.” The statement goes on to provide that “[t]he increase in the maximum amount of flood insurance coverage available under the NFIP could affect the minimum amount of flood insurance required for both existing and future loans secured by these Other Residential Buildings.” (Emphasis added.)

As lenders are no doubt aware, the flood insurance regulations generally require that if a lender determines that the amount of flood insurance covering a building securing a designated loan¹ is insufficient (or has expired), the lender is required to send a notice (commonly referred to as the “45-day notice”) advising the borrower of that fact, and that the borrower is required to provide evidence of sufficient coverage within 45 days. If the borrower fails to do so, the lender is then required to force place a policy and is permitted to charge the borrower for the premium and related fees. The interagency statement points out this obligation, stating that if a lender (or its servicer) determines on or after June 1, 2014 that flood insurance coverage is insufficient due to the increase in the maximum coverage limit for Other Residential Buildings, the lender “should take steps to ensure that the borrower obtains sufficient coverage, including force placing insurance pursuant to federal law.” Although the interagency statement does not explicitly state that lenders are expected to conduct a portfolio review of their existing loans, this quoted language and the statement’s reference to existing loans certainly imply it.

Accordingly, the prudent lender will want to begin the process of reviewing its loan portfolio to identify loans secured by Other Residential Buildings and determine whether the insurance coverage is sufficient for each loan. If the lesser of “the three amounts” (that is, the lesser of the loan amount, the building’s replacement cost value or the NFIP maximum coverage limit) is the \$500,000 NFIP limit, then the lender will have to notify the borrower that flood insurance coverage is insufficient (that is, send the 45-day notice) and if the borrower does not supply evidence of sufficient coverage within the 45-day period, the lender should then force place coverage on the 46th day. Clients may contact Aldrich Bonnefin & Moore for further guidance regarding portfolio reviews.

Changes to the NFIP Minimum Deductibles

Biggert-Waters also revised the NFIP minimum deductibles and FEMA’s memorandum W-13070 implements these revisions. Lenders should take note of these revisions because when reviewing a private flood insurance policy under FEMA’s six criteria set forth in the NFIP Mandatory Purchase of Flood Insurance Guidelines (Guidelines), lenders will need to consider the deductibles of the private flood insurance policy to determine whether the private flood insurance policy’s coverage is as broad as the coverage under the Standard Flood Insurance Policy. Although FEMA has rescinded the Guidelines, the six criteria laid out in the Guidelines

¹ The term “designated loan” refers to a loan secured by a building that is located in a special flood hazard area that is in a NFIP-participating community and, consequently, the loan is subject to the flood insurance regulations.

give lenders at least something on which to base their decisions regarding whether or not to accept a private flood policy.

In somewhat generalized terms, for new policies and renewals that are effective on or after June 1, 2014, the NFIP minimum deductibles will be as follows:

- For full-risked policies:
 - o If the building coverage is \$100,000 or less, the minimum deductible will be \$1,000 for building coverage and \$1,000 for contents coverage; and
 - o If the building coverage exceeds \$100,000, the minimum deductible will be \$1,250 for building coverage and \$1,250 for contents coverage;
- For Pre-FIRM subsidized policies:
 - o If the building coverage is \$100,000 or less, the minimum deductible will be \$1,500 for building coverage and \$1,500 for contents coverage; and
 - o If the building coverage exceeds \$100,000, the minimum deductible will be \$2,000 for building coverage and \$2,000 for contents coverage.

Refer to Appendix D to W-13070 (as revised by W-14003) for more specific information regarding the changes to the NFIP minimum deductibles.

Revised Requirement to Escrow Flood Insurance Premiums

Under the current rules, a lender is required to escrow flood insurance premiums on residential improved real estate only if the lender requires the escrowing of funds to cover other property expenses, such as property taxes or premiums for hazard or fire insurance, in connection with the loan. Under Biggert-Waters, a lender will be required to escrow flood insurance premiums on residential improved real estate or a mobile home regardless of whether the lender requires the escrowing of other property expenses. In order to revise the flood insurance regulations to reflect this new escrow requirement (as well as implement other Biggert-Waters changes, as discussed below), the banking agencies (FDIC, FRB, OCC and NCUA) as well as the Farm Credit Administration issued a proposed rule in October 2013 (October 2013 Proposal). 78 FR 65107.

Originally, Biggert-Waters set forth an effective date of July 6, 2014. This is why the proposed escrow rules in the October 2013 Proposal were to apply to “any loan . . . that is outstanding or entered into on or after July 6, 2014.” (Emphasis added.) However, the 2014 Flood Reform Act delayed the effective date of the mandatory escrow requirement from July 6, 2014 to January 1, 2016. As a result, financial institutions have until 2016 to comply with the new mandatory escrow requirement.

As of May 30, 2014, the agencies had yet to issue a final rule in connection with the October 2013 Proposal. In addition to extending the effective date to 2016, the 2014 Flood Reform Act exempted several types of loans from the mandatory escrow requirement. As a result, it is possible that the agencies will issue a new proposed rule dealing with the escrow requirement. We will all have to stay tuned!

New Requirement to Accept “Private Flood Insurance”

Currently, when a lender is presented with a private flood insurance policy, the lender is to look to FEMA’s six criteria to determine whether the policy conforms with the mandatory flood insurance purchase requirements. If a private flood insurance policy met the six criteria, then a lender could accept that private policy. As discussed above, FEMA’s six criteria were set forth in its now-rescinded Guidelines.

With regard to private flood insurance, if a private flood insurance policy meets the definition of “private flood insurance” as set forth in Biggert-Waters, then a lender must, not may, accept that policy for purposes of the mandatory flood insurance requirements. However, in the Interagency Statement on the Impact of Biggert-Waters Act issued in March 2013 (see, for example, FDIC FIL-14-2013) (Interagency Statement), the banking agencies stated that this requirement, among others, is not effective until regulations are issued. In the October 2013 Proposal, the agencies proposed rules that would implement this requirement. The proposed definition of “private flood insurance” and the specific requirements that would apply when accepting a private flood insurance policy are similar to FEMA’s former six criteria. However, as noted above the agencies have yet to finalize the October 2013 Proposal. Once the final rule is issued, we’ll know when the duty to accept private flood insurance policies (and any conditions a private flood insurance policy will have to meet) go into effect.

Revised Requirement to Force Place Insurance

Pursuant to Biggert-Waters, it is permissible for a lender to charge a borrower for premiums and fees incurred for force-placed coverage beginning on the date the flood insurance coverage lapsed. In the October 2013 Proposal, the agencies proposed to amend their regulations to provide that the regulated lending institution or its servicer may charge the borrower for the cost of premiums and fees incurred for coverage beginning on the date on which flood insurance coverage lapsed or did not provide a sufficient coverage amount. The agencies stated in the Supplementary Information accompanying the October 2013 Proposal that the agencies interpret Biggert-Waters to permit a lender to force place a flood insurance policy purchased on behalf of a borrower that is effective the day after expiration of a borrower’s original insurance policy to ensure that it is continuous. See 78 FR at 65118.

Until the agencies issue finalize the October 2013 Proposal, we suggest that lenders continue to follow the current rule – that is, to not force place until 45 days after notifying the borrower of the lapse in flood insurance coverage. Since the lender will not be force placing insurance until the 46th day, it follows that there will be no charge for the insurance until the 46th day as well. Our rationale is that the risk of a lender being accused of force placing

insurance “too soon” seems significant enough to justify taking a more conservative approach, at least until the agencies issue a final rule or further guidance stating otherwise.

Revisions to the Special Information Booklet

Although not as well known, Biggert-Waters also required changes be made to the RESPA Special Information Booklet. Specifically, Biggert-Waters revised RESPA Section 5(b) to notify the borrower of the availability of flood insurance under the NFIP or from a private insurance company, regardless of whether the property is located in a special flood hazard area. The 2014 Flood Reform Act mandated additional revisions to the Special Information Booklet. Pursuant to the 2014 Flood Reform Act, the Special Information Booklet must include the following statement:

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.

In footnote 12 to the October 2013 Proposal, the agencies noted that the CFPB is the agency responsible for making revisions to the Special Information Booklet. 78 FR at 65110, n. 12. As of May 30, 2014, the CFPB had yet to issue a revised Special Information Booklet reflecting these requirements.

New Exemption to Mandatory Purchase of Flood Insurance

As currently drafted, the flood insurance regulations only exempt, in general terms, (1) state-owned property and (2) property securing any loan that is \$5,000 or less and its term is one year or less. The 2014 Flood Reform Act added a new exemption for any non-residential structure that is detached from the primary residential structure. Specifically, the 2014 Flood Reform Act provides that “flood insurance shall not be required, in the case of any residential property, for any structure that is part of such property but is detached from the primary residential structure of such property and does not serve as a residence.” This is generally thought to refer to detached garages and other detached structures.

Although the relevant section of the Flood Disaster Protection Act (42 USC 4012a(c)) has already been amended to reflect the new exemption, the agencies have yet to issue a proposed, let alone finalized, rule to amend the flood insurance regulations to reflect this new exemption. Accordingly, it seems as though lenders should not yet rely on the detached structure exemption at this time, but wait until the agencies issue a final rule or other guidance on point.

Putting this altogether, until the agencies issue a final rule or the CFPB revises the Special Information Booklet, it appears as if the only flood insurance changes lenders will need to address in the near future (at least by June 1, 2014) are the increase of the NFIP maximum coverage limit to \$500,000 for Other Residential buildings and the changes to the NFIP minimum deductibles. Aldrich Bonnefin & Moore will notify BCG members of any flood insurance developments by posting updates on the BCG website and articles in the BCG

Newsletter. Once the agencies issue a final rule or formal guidance as to these outstanding issues, BCG will hold a Monthly Telephone Briefing to discuss the changes to the flood insurance regulations.