

October 1, 2013

MEMORANDUM TO: The Board of Directors

FROM:

Mark Pearce
Director
Division of Depositor and Consumer Protection



SUBJECT:

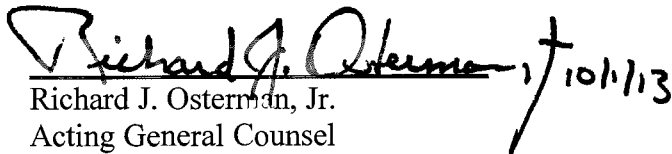
Joint Notice of Proposed Rulemaking for the Purpose of Implementing
Certain Aspects of the Biggert-Waters Flood Insurance Reform Act

Summary of Recommendation

Staff recommends that the FDIC's Board of Directors approve and authorize the attached Notice of Proposed Rulemaking entitled *Loans in Areas Having Special Flood Hazards* (NPR) for publication in the *Federal Register*, for a 60-day public comment period. The NPR would solicit comments on the proposed regulation which would implement certain requirements set forth in the Biggert-Waters Flood Insurance Reform Act of 2012¹ (the Act) related to the mandatory purchase of flood insurance requirements. The proposed regulation would amend Part 339 of Title 12 of the Code of Federal Regulations.

If approved, the NPR would be issued jointly by the FDIC, the Board of Governors of the Federal Reserve System (Board), the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration (NCUA), and the Farm Credit Administration (FCA) (collectively, the "Agencies").

CONCUR:


Richard J. Osterman, Jr.
Acting General Counsel
Legal Division

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

Background

The National Flood Insurance Program (NFIP) is administered by the Federal Emergency Management Agency (FEMA) pursuant to the National Flood Insurance Act of 1968 (1968 Act) and the Flood Disaster Protection Act of 1973 (FDPA).² The 1968 Act made Federally subsidized flood insurance available to owners of improved real estate or mobile homes located in special flood hazard areas (SFHA) if their community participates in the NFIP.³ A community establishes its eligibility to participate in the NFIP by adopting and enforcing floodplain management measures to regulate new construction and by making substantial improvements within its SFHAs to eliminate or minimize future flood damage.⁴

Until the adoption of the FDPA in 1973, the purchase of flood insurance was voluntary. The FDPA mandated the purchase of flood insurance and directed the FDIC, Board, OCC, and NCUA to issue regulations to implement the new requirement. The regulations directed lenders to require flood insurance on improved real estate or mobile homes serving as collateral for a loan if the secured property was located in a SFHA in a participating community. The regulations also required lenders to notify borrowers that the property is located in a SFHA and of the availability of Federal disaster assistance with respect to the property in the event of a flood.

The National Flood Insurance Reform Act of 1994 (Reform Act) comprehensively amended the NFIP. The Reform Act established new requirements for federally regulated lending institutions, such as escrow for flood insurance premiums and the force-placement of flood insurance coverage.⁵ The Reform Act was intended to increase compliance with the mandatory flood insurance purchase requirements and participation in the NFIP in order to provide additional funds to decrease the financial burden of flooding on the Federal government, taxpayers, and flood victims.⁶

The Biggert-Waters Act, signed into law on July 6, 2012, significantly revised federal flood insurance legislation.⁷ The Act: 1) permitted a lender or servicer to charge a borrower for the cost of force-placed flood insurance coverage commencing on the date on which a borrower's flood insurance coverage lapsed or did not provide a sufficient coverage amount, and includes

² 42 U.S.C. §§ 4001-4129. FEMA's regulations implementing the NFIP appear at 44 CFR parts 50-79 (2012).

³ A special flood hazard area (SFHA) is an area within a flood plain having a one percent or greater chance of flood occurrence in any given year. 44 CFR 59.1. SFHAs are delineated on maps issued by FEMA for individual communities. 44 CFR part 65.

⁴ 44 CFR part 60.

⁵ "Force-placed flood insurance" means insurance obtained by a lender or a servicer when the borrower has failed to maintain or renew flood insurance on the residential property as required of the borrower under the terms of the mortgage.

⁶ The Reform Act broadened the definition of "federally regulated lending institution" to include the FCA, thereby increasing the number of lending institutions subject to the mandatory flood insurance purchase requirement.

⁷ Among other amendments, the Act increased the maximum civil money penalty for a pattern or practice flood violation to \$2000, and also removed the annual penalty cap from the statute.

force-placed insurance termination and borrower refund provisions;⁸ 2) directed the Agencies to promulgate regulations to require lending institutions to accept private flood insurance that meets the new statutory definition of “private flood insurance”; and 3) with certain exceptions, directed the Agencies to issue regulations to require, for residential mortgages outstanding or entered into on or after July 6, 2014, that all premiums and fees for flood insurance for covered properties be paid and deposited in an escrow account, with the same frequency as payments on the loan are made for the duration of the loan. This NPR is consistent with the statute.

However, the Act does not specifically set forth certain aspects for the implementing regulations. For example, the Act is silent about a regulated lending institution’s ability to accept a flood insurance policy by a private insurer that does not meet the statutory definition. Additionally, while the Act specifies that the escrow requirement applies to loans outstanding as of July 6, 2014, the Act does not address when a lending institution is required to begin complying with the escrow requirement. Finally, the Act does not state when coverage under a flood insurance policy lapses.

Section-by-Section Description of the Proposed Rule

The preamble of the NPR includes a set of questions to elicit specific public comment on the issues discussed above. The questions include:

- Whether flood policies issued by private insurers that do not meet the statutory definition of “private flood insurance” should be permitted to satisfy the general mandatory flood insurance purchase requirement or whether regulated lending institutions may only accept private flood insurance policies that meet the statutory definition?
- Whether regulated lending institutions should be provided the option of complying with the escrow requirement earlier than the dates set forth in the proposal?
- Whether the Agencies’ interpretation of the term “lapsed” is consistent with the insurance industry’s use of the term and as to whether further clarification is necessary on when a lender or servicer may begin to charge for force-placed flood insurance?

Section 339.2 – Definitions.

The proposal would include the new statutory definition of “private flood insurance.”

Section 339.3 – Requirement to purchase flood insurance where available.

Consistent with the Act, the proposal would require that regulated lending institutions accept private flood insurance to satisfy the mandatory purchase of flood insurance requirement if the private flood insurance meets the criteria set forth in the statutory definition of “private flood insurance.”

⁸ The civil money penalty and force-placed insurance provisions of the Act were effective immediately upon enactment of the Act. The Agencies propose to amend the section of their respective regulations that pertains to force-placed insurance to reflect the Act’s force-placement provisions.

The Agencies are proposing a “safe harbor” to facilitate compliance with the provision to accept “private flood insurance” policies. Under the proposed safe harbor, the Agencies will deem a flood insurance policy issued by a private insurer to have met the definition of “private flood insurance” if a State insurance regulator makes a determination that the policy meets the statutory definition.

Section 339.5 – Escrow requirement.

Consistent with the Act, the proposal would require regulated lending institutions, or servicers acting on their behalf, to escrow premiums and fees for flood insurance for any residential loans secured by residential improved real estate or a mobile home with the same frequency as payments on the loan are made for the duration of the loan. The proposal includes the statutory exception for those institutions with the following characteristics: 1) total assets of less than \$1 billion and 2) as of July 6, 2012, the institution was not required under Federal or state law to escrow for taxes or insurance premium and as of that date, the institution also did not have a policy of requiring the escrow of taxes, insurance premiums or other charges for loans secured by a building or mobile home.

In addition, the proposal would exclude several types of loans from the escrow requirement not specifically set forth in the Act: 1) business, commercial or agriculture loans; 2) second liens; and 3) condo association policies. The subsequent amendment to the Act which inserted the word “residential” prior to every reference to “improved real estate” clarified that loans made for a business, commercial or agricultural purpose should be excluded.⁹ Agencies’ staff interpreted this amendment to therefore exclude these types of loans from the escrow requirement. Second liens would be excluded because most lenders in a subordinate lien position will look to the primary lender to establish escrow accounts. With respect to condo association policies, flood insurance coverage is provided by a party other than the borrower, *i.e.*, a condo association. Escrowing flood insurance premiums in such a situation does not seem necessary as the borrower is not directly responsible for any flood insurance premiums or fees.

The Agencies are proposing to require banks to begin escrowing based on a staggered start date to alleviate the burden to lenders and borrowers. For example, for designated loans outstanding on July 6, 2014, escrowing would begin with the first loan payment on or after the first renewal date of the borrower’s flood insurance policy on or after July 6, 2014. For any loan that becomes a designated loan after July 6, 2014, escrowing would begin with the first loan payment after the flood insurance policy is established.

The proposal would also require lenders to provide written notice to borrowers of the new escrow requirement. The notice must be provided at least 90 days in advance of escrowing for outstanding loans or with the Notice of Special Flood Hazards (App. A), which is already provided for new designated loans, or with the force-placement notice, which is already provided for loans that become designated loans after they are made.

⁹ Pub. L. 112-281, 126 Stat. 2485 (Jan. 14, 2013).

The proposal also provides transition rules for a change in status of an institution that may initially qualify for the exception, but later grows to exceed the \$1 billion asset size threshold. Similar to the Board's Regulation II, the proposal provides institutions approximately six months from the date of a status change to begin complying with the escrow requirement.

Section 339.7 – Force-placement of flood insurance.

Consistent with the Act, the proposal would amend the existing regulatory provisions regarding force-placement of flood insurance to clarify, in conformity with the Act, 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 did not provide a sufficient coverage amount. The proposal also would set forth the circumstances under which a lender or its servicer must terminate force-placed flood insurance coverage and refund payments to a borrower. In addition, the proposal describes the type of documentary evidence a lender must accept to confirm that a borrower has obtained an appropriate amount of flood insurance coverage.

Section 339.9 – Notice of special flood hazards and availability of Federal disaster relief assistance.

Consistent with the Act, the proposal would require regulated lending institutions to disclose to a borrower in the Notice of Special Flood Hazards that: (i) flood insurance is available from private insurance companies that issue Standard Flood Insurance Policies (SFIPs) on behalf of the NFIP or directly from the NFIP; (ii) flood insurance that provides the same level of coverage as an SFIP under the NFIP may be available from a private insurance company; and (iii) the borrower is encouraged to compare the flood insurance coverage, deductibles, exclusions, conditions, and premiums associated with flood insurance policies issued on behalf of the NFIP and policies issued on behalf of private insurance companies and to direct inquiries regarding the availability, cost, and comparisons of flood insurance coverage to an insurance agent.

Appendices A, B, C to Part 339 – Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance; Sample Form of Notice of Requirement to Escrow for Outstanding Loans; Sample Escrow Requirement Clause for Loans that Become Designated Loans.

The proposal amends the current Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance to add language concerning the availability of private flood insurance coverage and the Act's requirements with respect to the notice to the borrower of special flood hazards and escrow.

The Agencies are proposing to add an additional sample notice form, the Notice of Escrow Requirement, as a new Appendix B to assist institutions in complying with the proposal's requirement to inform existing borrowers about the new escrow requirement. This notice would be provided for existing loans in those situations when a regulated lending institution must begin

escrowing, but neither of the other standard forms apply.¹⁰ Finally, the Agencies are also proposing to add a new Appendix C, a sample clause regarding the new escrow requirement that may be included with the force-placement notice when a loan becomes a covered loan.

Technical Corrections: The Agencies have also proposed needed technical corrections. For example, the Agencies' current flood insurance regulations refer to the "Director" of FEMA. The correct title for the head of that agency is "Administrator." The proposal would correct all references to the head of FEMA.

FDIC Integration of Savings Association Flood Insurance Regulations: Staff proposes to integrate the FDIC's flood insurance regulations for State non-member banks and State savings associations by adding language to 12 C.F.R. Part 339, its flood regulation for State non-member banks, to make it applicable to both State non-member banks and State savings associations and to remove the separate flood regulation for State savings associations, 12 C.F.R. Part 391/ Subpart D. Parts 339 and 391/Subpart D are nearly identical and contain no substantive differences, as they were originally adopted through an interagency rulemaking process.

Recommendation

Based on the foregoing, staff recommends that the Board approve the attached Resolution to adopt and authorize the publication in the *Federal Register* the attached NPR for public comment.

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Attachments

¹⁰ In a situation where a lender must establish an escrow account for flood insurance premiums, but neither force placement nor the making, increase, renewal or extension of a loan is involved, then neither the Notice of Special Flood Hazards nor the force-placement notice would be provided.