New Flood Insurance Regulations – What You Need to Know

Brian M. Shea, CRCM, CAMS
Before we get started…

- Today’s presentation slides can be downloaded at www.wolfandco.com/webinars/2015
- The session will last about 45 minutes, and we’ll then have time for Q & A.
- Our audience will be muted during the session.
- Please send your questions in using the “Questions Box” located on the webinar’s control panel.
About Wolf & Company, P.C.

- Established in 1911
- Offer Audit, Tax, and Risk Management services to over 250 financial institutions
- Offices located in:
  - Boston, Massachusetts
  - Springfield, Massachusetts
  - Albany, New York
  - Livingston, NJ
- Nearly 200 professionals

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  – IT Assurance Services Group
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• Provide Risk Management Services in 27 states and 2 U.S. territories
Today’s Presenter

Brian M. Shea, CRCM, CAMS
Regulatory Compliance Manager
Phone: (617) 261-8133
Email: bshea@wolfandco.com
Today’s Objectives

• Learn about flood insurance mandatory escrow rules
• Learn about flood insurance exemption for detached residential structures
• Learn about changes to flood insurance force placement rules
• Determine what steps your institution should take to be ready to implement these rules
• Learn about additional rules for Massachusetts institutions
Outline

1. How Did We Get Here?
2. Mandatory Escrow Requirement
3. Detached Structures
4. Force Placement
5. Questions?
6. Massachusetts-specific Update
How Did We Get Here?

- 2012 Biggert-Waters Act
- 2014 Homeowner Flood Insurance Affordability Act
- Proposed Rule issued October 24, 2014
- Final Rule issued June 22, 2015
Key Changes

1. Mandatory escrow of flood insurance premiums (certain exceptions apply)
2. New exemption for certain detached structures on residential properties
3. Changed provisions relating to force placed flood insurance

While Biggert-Waters also contains rules over private insurance, the new regulation does not address this; it is expected at a future time.
Effective Dates

October 1, 2015

- New exemption for certain detached structures on residential properties
- Changed provisions relating to force placed flood insurance

January 1, 2015

- Mandatory escrow of flood insurance premiums (certain exceptions apply)
Mandatory Escrow Requirement

• For loans **made, increased, extended or renewed** that require flood insurance on residential real estate or a mobile home, escrowing of the flood insurance premium is mandatory as long as the **triggering event** occurs on or after January 1, 2016

• The escrow payments must follow the same schedule/frequency as the loan payments

• If loan is subject to RESPA, escrow accounts must comply with RESPA rules
Mandatory Escrow Requirement

**Exemptions**

- Extensions of credit primarily for business, commercial or agricultural purposes
- Loans secured by subordinate liens (if adequate flood insurance coverage is already in place)
- Home equity lines of credit
- Loans with terms of 12 months or less
- Non-performing loans (loans that are 90 days or more past due)
Mandatory Escrow Requirement

Exemptions

• Loans secured by units in a condo association, cooperative, homeowners association or other applicable group, provided that coverage is provided by the association or group, the coverage meets minimum purchase requirements and the premium is paid by the association or group as a common expense (The exception does not apply to supplementary policies purchased by the borrower)
Exemptions

• For example, if a condo association’s policy only provides $200,000 in coverage, and the minimum required is $250,000, the borrower would be responsible for purchasing a supplementary $50,000 policy. The $50,000 policy is not exempt from the escrow requirements.
Mandatory Escrow Requirement

Small Lender Exemptions (All must apply)

• Institution has total assets of less than $1 billion as of December 31 of either of the prior 2 calendar years
• On or before July 6, 2012, institution was not required by federal or state law to escrow taxes or insurance for the term of the loan
• On or before July 6, 2012, institution did not have a policy of consistently and uniformly requiring escrow of taxes, insurance premiums/fees for any loans secured by residential improved real estate/mobile homes
• Rules apply for loans with triggering event on or after July 1 of first calendar year where institution loses exemption
Mandatory Escrow Requirement

Written Notice

- Institutions are required to provide a written notice of the mandatory escrow requirement.
- Language has been added to the Notice of Special Flood Hazards model form, located at Appendix A in the regulation.
- If institution loses small lender status, notice must be provided to affected borrowers by September 30 of the first calendar year where it loses such status.
Mandatory Escrow Requirement

• For existing loans originated prior to January 1, 2016, the institution is only required to offer the option to escrow
• This must be offered even if the escrow option was declined previously
• If accepted, escrow must take place as soon as reasonably practicable
• This applies to loans secured by residential improved real estate or mobile homes
• By June 30, 2016, institutions must provide a written notice to borrowers of this option (model language included in regulation appendix)
Detached Structures

Mandatory purchase of flood insurance does not apply to structures that are:
• Detached from the primary structure on residential properties AND
• Do not serve as a residence

Residential does not include structures used for agricultural, commercial, industrial or business purpose

Lenders may optionally require flood insurance coverage
Detached Structures

Reasonable steps should be taken to determine if a structure serves as a residence.

For example, presence of kitchen, sleeping and bathroom facilities may be considered, although their absence does not automatically disqualify structure from residence status.

Monitoring of residential status of detached structure is not required after initial determination unless there is a triggering event (loan is made, increased, renewed or extended).
Institutions are now **allowed** to force place coverage and charge borrowers for the cost of coverage beginning on the date that the existing policy lapses or becomes insufficient. The institution is only **required** to force place after 45 days have passed.

The institution must accept an insurance policy declaration page that includes the existing flood insurance coverage along with the name and contact information for the insurance company or agent and making any necessary inquiries into the adequacy of insurance to ensure that it complies.
Force Placement

Within 30 days of receipt of confirmation of existing flood insurance coverage, the institution must:

• Notify the insurance provider to terminate force placed coverage AND

• Refund to the borrower any premiums and fees assessed to the borrower in connection with the force placed policy during periods of overlap
What actions should my institution take?

**Steps to consider**

- Become familiar with key effective dates so as to plan implementation around them
- Determine applicability of escrow rules to institution
- Consider the risks and benefits over any of the rules that are optional (detached structures, certain force placement rules) and decide on the institution’s policy
- Update written policy and procedure documents
- Provide training and assistance for key lending and other impacted staff
- Review notices, worksheets, checklists and other documents for updates
What actions should my institution take?

Steps to consider

• Consider enhancing or implementing secondary checks where deemed necessary
• Ensure monitoring procedures in place to ensure correct processes have been implemented
• Work with systems, vendors and other service providers
• Ensure audit plan is updated to include coverage of the new rules
• For those institutions not subject to the escrow rules, be aware of the applicability rules and conditions so as to be ready if your institution becomes subject to them
Questions?

Brian M. Shea, CRCM, CAMS  
Regulatory Compliance Manager  
Phone: (617) 261-8133  
Email: bshea@wolfandco.com

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Massachusetts Flood Rules

Massachusetts General Law Chapter 183, Section 69 became effective November 20, 2014

The Massachusetts Division of Banks issued regulation 209 CMR 57, implementing the regulation. The Division of Banks also issued a Frequently Asked Questions document on their web site
Lenders cannot require, in a mortgage, note or otherwise that a purchaser or owner of residential property purchase or pay for flood insurance on the property that:

- Is at a coverage amount exceeding the principal balance
- Includes contents coverage or
- Includes a deductible of less than $5,000

The purchaser or owner can exceed or obtain these voluntarily, but the lender cannot require them.
Massachusetts Flood Rules

The regulation carried an effective date of September 11, 2015 although certain provisions regarding the required notice have an extended effective date of November 10, 2015 (there are pre-existing statutory requirements in place that must be followed until then).

The regulation applies the first time a policy is renewed after September 11, 2015 or when the loan is refinanced, whichever applies first. Lenders can combine the required flood notice with other disclosures or notices through November 9, 2015 in order to have time to update systems.
Massachusetts Flood Rules

**Applicability**
Applies to a mortgage loan secured wholly or in part by a mortgage on residential property located in a special flood hazard area for which flood insurance is required under NFIP.

Includes residential first mortgage loans, subordinate liens, home equity loans, home equity lines of credit, reverse mortgages
Applicability
Residential property is defined as real property located in Massachusetts for which there is a 1-4 family dwelling occupied or to be occupied in whole or in part by the obligor.

• Is not exclusive to primary residences
• Does not include residential properties taken as collateral for commercial loans that do not fit this definition (ex. 5+ family apartment building)
Massachusetts Flood Rules

**Loan Balance Rules**

- Loan balance used should be balance at the beginning of the year that the flood insurance policy is in effect (policy year, not calendar year)
- Borrower has option to request coverage amount be lowered to comply with this every year, if no indication is made then it is permitted to be left as is (absent contractual obligations)
- For lines of credit, should include full value of credit line, not just amount outstanding
Massachusetts Flood Rules

**Loan Balance Rules**

- If an agency or guarantor for the loan (ex. FHA) requires insurance in excess of the principal balance, or requires contents coverage or a lower deductible, it is not a violation. The lender must still provide the notice required by the law and clarify for the borrower differences in the coverage for the loan and the statements in the notice.
Notice

• A Notice About Flood Insurance coverage must be provided at the same time and in the same method as the Notice of Special Flood Hazards required by federal rules.

• If there are multiple lenders, only one notice is required (lenders and representatives should decide amongst themselves who will provide). The lender is responsible for ascertaining whether its representative has provided the notice and must retain a written assurance.
Notice

• For existing loans, the notice only needs to be provided if:
  – There is an increase, extension or renewal of the existing loan
  – The addition of new coverage
  – An increase in the amount of coverage in excess of the policy amount in effect for the expiring policy period
  – For delinquencies, at the time a notice is required to be provided under federal force placement rules
Massachusetts Flood Rules

Notice Content – Must follow Model Format

- Name of the borrower(s)
- Address of the residential property to be insured
- Name and address of the provider of the notice
- A statement on the limitations imposed by MGL Chapter 183 Section 69
- A section for signature of the borrower to acknowledge receipt (however the lender is not required to obtain such signature when they are providing the notice prior to the forced placement of flood insurance)
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