

REGULATORY ALERT

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: October 2015 NO: 15-RA-05

TO: Federally Insured Credit Unions

SUBJ: Statutory Changes to Flood Insurance Rule

ENCL: [Loans in Areas Having Flood Hazards](#)

ACTION: Compliance Required as of October 1, 2015 and January 1, 2016

Dear Board of Directors and Chief Executive Officer:

Following changes in flood insurance laws, the NCUA Board approved a final rule that updated Part 760 of NCUA's rules and regulations, [Loans in Areas Having Flood Hazards](#). This final rule incorporates several changes related to the force-placement of flood insurance, exemptions for detached structures, and escrow requirements for flood insurance payments.

For federally insured credit unions that originate mortgage loans, this Regulatory Alert reemphasizes the requirements of the final rule and reiterates the effective dates of the rule's key provisions.

The final rule implements the following changes:

Rule Change	Effective Date
Incorporates statutory amendments related to the force-placement of flood insurance	October 1, 2015
Incorporates a statutory exemption to the general mandatory flood insurance purchase requirement for detached structures	
Establishes requirements for certain credit unions to escrow flood insurance payments on residential improved real estate securing any designated loan	January 1, 2016

The escrow requirements apply primarily to credit unions with at least \$1 billion in assets. Credit unions *under \$1 billion* do not have to comply with the escrow requirements *unless*:

- The credit union is required by applicable federal or state law to escrow taxes or insurance for the term of the loan; or
- The credit union has a policy of consistently and uniformly requiring escrow of taxes and insurance.

What Should You Do?

If your credit union offers mortgage loans to members, you should take the following actions to implement the regulatory requirements of the final rule:

- Determine the business and process changes needed to comply with the rule.
 - Test and implement technology changes.
 - Develop and provide training for management and staff.
- Determine if your credit union is required to comply with the escrow requirements.¹
 - If the escrow requirements apply to your credit union, develop a plan to escrow flood insurance premiums and fees for designated loans secured by residential improved real estate or mobile homes that are made, increased, extended, or renewed on or after January 1, 2016.
 - Review the plan with executive management.
 - Roll out changes in time to issue the new escrow accounts to borrowers.
- Identify third parties affected by the rule, including vendors and mortgage service providers.
 - Contact vendors to make sure they can implement the necessary changes and deliver relevant software on time, and address any questions about the new processes and who will perform which tasks; and
 - Plan how you will work with settlement service providers to ensure the accuracy of disclosures.

Please read this document in its entirety for more information about the rule changes and how you can ensure compliance.

Background

On July 6, 2012, President Obama signed the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters Act) into law, reauthorizing and reforming the National Flood Insurance Program through September 20, 2017.

On March 21, 2014, President Obama signed into law the Homeowner Flood Insurance Affordability Act 2014 (HFIAA) which amended the Biggert-Waters Act and made additional changes to other aspects of the program.

On July 21, 2015, NCUA and other financial regulatory agencies issued a joint final rule amending their respective regulations regarding loans in special flood hazard areas. This final rule amends NCUA's flood insurance regulation (12 CFR 760) to incorporate and implement certain provisions in the Biggert-Waters Act and HFIAA regarding force-placement of flood insurance, detached structures, and escrowing flood insurance premiums and fees. These changes are outlined in more detail below.

¹ The rule provides a small lender exception to the escrow requirement. The **Frequently Asked Questions about Escrow** section of this document provides further information about this exception.

Force-Placed Insurance

The statutory force-placement provisions apply to all federally insured credit unions. The regulatory requirements on force-placement are effective October 1, 2015. These changes:

- Clarify that a credit union or its servicer has the authority to charge a borrower for the cost of force-placed flood insurance commencing on the date on which the borrower's coverage lapsed or became insufficient;
- Provide that, under certain circumstances, a credit union or its servicer must terminate force-placed insurance coverage and refund payments to a borrower for any period of overlap in coverage; and
- Describe the documentary evidence a credit union must accept to confirm that a borrower has obtained an appropriate amount of flood insurance coverage.

Detached Structures

The statutory detached structures provisions apply to all federally insured credit unions. The regulatory requirements on detached structures are effective October 1, 2015.

However, the final rule incorporates a new detached structures *exemption* to the mandatory flood insurance purchase requirement. This exemption applies to 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*.²

The rule also clarifies the following terms:

- “A structure that is part of a residential property” is a structure used primarily for personal, family, or household purposes, and not used primarily for agricultural, commercial, industrial, or other business purposes.
- A structure is “detached” from the primary residential structure if it is not joined by any structural connection to that structure.
- “Serve as a residence” is based upon the credit union's good faith determination that a structure is intended for use or is actually used as a residence. This generally includes sleeping, bathroom, or kitchen facilities.

Escrow Requirements

The final rule requires credit unions or servicers acting on their behalf to escrow flood insurance premiums and fees for designated loans secured by residential improved real estate or mobile homes that are made, increased, extended, or renewed (“triggering events”) on or after January 1, 2016.

² Even if an exemption would apply, a credit union may still elect to require flood insurance on a detached structure to protect the collateral securing the mortgage.

Frequently Asked Questions about Escrow

Does the escrow requirement apply to all federally insured credit unions?

The final rule provides an exception to the escrow requirement for smaller federally insured credit unions. A credit union qualifies for the small lender exception if it has total assets of less than \$1 billion as of December 31 of either of the two prior calendar years and provided that, as of July 6, 2012, the credit union:

- was not required by applicable federal or state law to escrow taxes or insurance for the term of the loan; and
- did not have a policy of consistently and uniformly requiring escrow of taxes and insurance.

Are any types of designated loans excluded from the escrow requirement?

Yes. The following types of designated loans are excluded from the escrow requirement:

- Loans that are in a subordinate position to a senior lien secured by the same property for which flood insurance is being provided;
- Property that is covered by a flood insurance policy provided by a condominium, cooperative, homeowner association, or other applicable group, provided certain conditions are met;
- Loans that are extensions of credit primarily for a business, commercial or agricultural purpose, even if secured by residential real estate;
- Home equity lines of credit;
- Nonperforming loans (loans that are 90 days or more past due that remain nonperforming until permanently modified or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full); and
- Loans with terms not longer than 12 months.

What happens if a credit union determines one of the above designated loan exceptions no longer applies to a designated loan?

In such a case, the credit union must begin escrowing flood insurance premiums and fees for the formerly excepted loan as soon as reasonably practicable.

Does a credit union have to notify a borrower of the escrow requirement?

Yes, a credit union must provide notice on the escrow requirement with or in the *Notice of Special Flood Hazards*, which is already required to be provided to the borrower. Appendix A of the final rule includes revised sample language concerning the escrow requirement to be included with or in the *Notice of Special Flood Hazards*, as applicable.

Must a credit union escrow flood insurance premiums and fees for designated loans outstanding as of January 1, 2016, without a triggering event?

No. However, credit unions subject to the escrow requirement must offer and make available to borrowers the option to escrow flood insurance premiums and fees for designated loans that are

outstanding as of January 1, 2016. **Credit unions must provide information to borrowers about this escrow option by June 30, 2016, and implement the escrow as soon as reasonably practicable after receiving a borrower's request to escrow.**

Does the final rule provide sample language to notify borrowers about the escrow option?

Yes. Appendix B, *Sample Clause for Option to Escrow for Outstanding Loans*, is included in the rule to help credit unions comply with the requirement to inform borrowers of outstanding designated loans about their option to escrow flood insurance premiums and fees.

What happens if a credit union qualifies for the small institution exception as of December 31, 2015, but no longer qualifies for the exception in a later year?

Transition rules for credit unions that no longer qualify for the small lender exception are provided in the final rule, and outlined below:

- **Escrow Requirement:** A credit union that no longer qualifies for the small lender exception must begin to escrow flood insurance premiums and fees for designated loans that have a triggering event on or after July 1 of the first calendar year in which the exception no longer applies.
- **Escrow Option:** A credit union that no longer qualifies for the small lender exception must offer and make available to borrowers the option to escrow flood insurance premiums and fees for any designated loans that are outstanding as of July 1 of the first calendar year in which the exception no longer applies. Credit unions must provide a notice to borrowers about this escrow option by September 30 of the first calendar year in which the exception no longer applies, and implement the escrow as soon as reasonably practicable after receiving a borrower's request to escrow.

Example for Credit Unions that Outgrow the Small Lender Exception:

Credit union that qualify for the small lender exception in 2016 but later report assets of \$1 billion or more as of December 31, 2016 and December 31, 2017 will be required to begin escrowing for designated loans made, increased, extended, or renewed on or after July 1, 2018.

These credit unions will be required to provide notice of the option to escrow for designated loans that are outstanding as of July 1, 2018 by September 30, 2018.

If you have questions about the new regulatory requirements, please contact your NCUA Regional Office or state supervisory authority.

Sincerely,

/s/

Debbie Matz
Chairman