OUTLOOK LIVE TRANSCRIPT

INTERAGENCY FLOOD INSURANCE REGULATION UPDATE

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Note: Please use in conjunction with the presentation slides (slides and handouts).

MICHAEL VANDER VELDE – INTRODUCTION

Alright, thank you. Good afternoon, good morning, depending on where you are, and welcome to *Outlook Live*. I'm Mike Vander Velde with the Federal Reserve and I'll be your facilitator. Today we'll get an update on interagency flood insurance regulation, and our presenters come from the Federal Reserve, FCA, FDIC, NCUA and the OCC. And we are going to hear from them in a just a moment, but first let's jump over to slide number two and talk about the logistics of this call. If you haven't done so yet, go ahead and click on the webinar link (https://www.webcaster4.com/Webcast/Page/577/10725) that you received after registering. Or, you can head over to our website as seen on slide 1, and that address is http://www.consumercomplianceoutlook.org/. There you can find the session materials and, eventually, the archive of the call. Now, speaking of those materials, you may have noticed a couple of e-mails with links to download the handout and the slides. We are hearing that those links are not working for everyone. They are for some people but not for others. We are going to figure that out, but in the meantime, you can find them on our website. Again that's http://www.consumercomplianceoutlook.org/. Just a quick note on the webinar: We do encourage you to listen to the audio through your PC, but we have a thousand phone lines available that you can access at any time. As for questions, our presenters received a few in advance, and we are encouraging you to submit your new questions by clicking the "Ask Question" button right there in the webinar tool. Okay, with that said, I'm going to pass the mic over to host of our call from the San Francisco Fed, Mr. Jason Lew. Jason, take it away.

JASON LEW – MODERATOR COMMENTS

Great, thanks, Mike. Hello, everyone. Again, my name is Jason Lew, and welcome to *Outlook Live*. It's my pleasure to be opening today's webinar on the interagency flood insurance regulation update. During this session, representatives from the Board of Governors of the Federal Reserve System, Farm Credit Administration, FDIC, NCUA, and the OCC will discuss the recent updates to the agencies' flood insurance regulations. Before I hand things off to our speakers, I did want to mention that the Federal Reserve System also publishes a quarterly newsletter, entitled *Consumer Compliance Outlook*. Both the *Outlook Live* webinars and the *Consumer Compliance Outlook* newsletters are part of the Federal Reserve System's outreach activities, are free of charge, and may be accessed at www.consumercomplianceoutlook.org. So, with that, I will go ahead and hand things off to our first speaker. Lanette, the floor is yours.

LANETTE MEISTER – AGENDA OVERVIEW

Thank you, Jason, and good afternoon or good morning, everyone. Welcome to our interagency flood insurance regulation update. Before we launch into the agenda, I just want to make sure that you know who all is here in the room with me. I'm joined by Vivian Wong, who is also with the Federal Reserve Board; Mary Alice Donner and Paul Gibbs, from the Farm Credit Administration; Alex Cheng and Navid Choudhury, from the FDIC; Sarah Chung and Judy Graham, from the National Credit Union Administration; and Rhonda Daniels and Margaret Hesse, from the Office of the Comptroller of the Currency.

And now to spend a few minutes on our agenda for today. During today's program we'll discuss the recent statutory changes to the federal flood insurance law, and also the regulatory actions the agencies have taken to implement those changes. Then, we will drill down and discuss the major provisions of the Joint Final Rule. Those provisions include the detached structures exemption, the escrow of flood insurance premiums and fees, and force placement of flood insurance. We have received a number of questions in advance of this session, so we have allowed plenty of time to answer those questions today. As Michael mentioned, if you have questions during the session, please use the link to send them to us. If there are questions that we can't get to before the end of the program, we are planning to publish additional responses in an upcoming edition of the Federal Reserve's *Consumer Compliance Outlook* newsletter. Okay, and now I'd like to turn the presentation over to Navid Choudhury, who will provide an overview of the recent statutory and regulatory changes. Navid?

NAVID CHOUDHURY – OVERVIEW OF REGULATORY STATUTORY CHANGES

Thank you, Lanette. The Flood Disaster Protection Act—or "FDPA"—was recently amended by the Biggert-Waters Flood Insurance Reform Act of 2012—or "Biggert-Waters"—and the Homeowner Flood Insurance Affordability Act of 2014—or "HFIAA". Slide five provides a general overview of these amendments. We will provide more detail about each of these provisions during today's presentation.

Biggert-Waters made four major changes to the flood insurance requirements. First, Biggert-Waters directed lending institutions to accept private flood insurance, as defined by Biggert-Waters, and to notify borrowers of the availability of private flood insurance. Second, it required institutions to escrow premiums and fees for flood insurance on any loan outstanding or entered into after July 6, 2014 that is secured by residential, improved real estate, unless the regulated lending institution meets the statutory small institution exception for certain institutions with assets of less than $1 billion. Third, Biggert-Waters amended the force placement requirement to clarify that institutions may charge a 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 sufficient coverage, and to clarify the procedures for terminating force-placed insurance. And fourth, Biggert-Waters increased from $385 to $2,000 the maximum civil money penalty that the Agencies must impose per violation when there is a pattern or practice of specified flood insurance violations, and it eliminates the limit on the total amount of penalties that the Agencies may assess against any individual regulated lending institution during any calendar year.

So, how did the passage of HFIAA impact mandatory flood insurance purchase requirements? First, HFIAA amended the Biggert-Waters escrow requirements so that escrow for flood insurance is only required on any loan made, increased, extended or renewed on or after January 1, 2016. HFIAA also created new loan-specific exemptions from this escrow requirement that will be discussed shortly. Lenders that are required to escrow will also be required to offer borrowers who have loans outstanding as of January 1, 2016 the option to escrow flood insurance. Lastly, HFIAA includes a new provision that excludes from the mandatory purchase requirement a "detached structure" on a residential property that does not serve as a residence.

Turning to slide 6, with respect to regulatory implementation of these requirements, the agencies have issued the following: First, the Agencies issued a proposed rule to implement the escrow, force placement, and private insurance provisions of the Biggert-Waters Act in October 2013. Since HFIAA, which amended the Biggert-Waters escrow provision, was adopted in 2014, the Agencies issued a proposed rule to implement the escrow and detached structure provisions of HFIAA in October 2014. And in July of this year, the Agencies issued a final rule to implement the escrow, detached structure, and force placement provisions. The Agencies indicated in the supplementary information accompanying the 2015 rule that they will address the private insurance provision in a separate rule-making. I would now like to turn things over to Vivian Wong, who will provide some more details about the 2015 final rule.

VIVIAN WONG – DETACHED STRUCTURE EXEMPTION

Thanks, Navid. Turning now to slide 7, we'll move on to some of the important provisions that the Agencies implemented in the final rule. Let's start with the detached structure exemption. The rule adopts a new exemption from the mandatory flood insurance purchase requirement for any structure that is a part of a residential property but is detached from the primary residential structure of the property and does not serve as a residence. Importantly, this exemption is not driven by the purpose of the loan, but by the presence of a residential property. So, the exemption is available in connection with consumer loans as well as loans made for business, commercial or agricultural purposes, if the loan is secured by a residential property. The detached structure exemption took effect on March 21, 2014, which was the date of enactment of HFIAA. It's also important to note the lender may require flood insurance on a detached structure, even though the statute doesn't require it, to protect the lender's and borrower's collateral securing the loan. There may be some detached structures that are of a relatively high value, such as a detached greenhouse or pool house, that serve as collateral for the loan. In instances like that, both the lender's and borrower's interest might be served by obtaining flood insurance coverage on such high value structures.

On to slide 8, let's spend a few minutes talking about the terminology introduced on the previous slide. What do we mean by the term "residential property"? A residential property is a property that is used primarily for personal, family or household purposes and not used primarily for commercial, agricultural or other business purposes. It doesn't matter whether the residential property is a single-family or multi-family, or even a mixed-use building—just as long as it is used primarily for residential purposes. What does it mean that the detached structure is a "part of a residential property"? This means that the structure itself is used primarily for personal, family or household purposes and not used primarily for agricultural, commercial, industrial or other business purposes. For example, a homeowner might have a shop in which he repairs vintage cars as a hobby. That's a structure that is part of a residential property. But, if the same homeowner had a shop on the same lot as his home, where he repairs cars as a business, that shop would not be a structure that is part of a residential property. A structure is "detached" from the primary residential structure if it's not joined by any structural connection to the residential structure. So, for example, if there's a house, and a workshop is connected to the house by a roofed breezeway, the workshop would not qualify as a "detached structure," since the breezeway is a structural connection between the house and the workshop.

And on to slide 9, let's talk about what we mean when we say that the detached structure doesn't "serve as a residence". To be exempt from the mandatory flood insurance purchase requirement, the detached structure also may not serve as a residence. The Agencies have determined that any structure that includes sleeping, bathroom or kitchen facilities—but not necessarily all three—could serve as a residence. The lender should focus on the structure's intended use. Therefore, even if the structure is meant to be used as a residence, but is currently vacant, the exemption would not apply. The Agencies have concluded that a practical approach to applying this exemption is to rely on the good faith determination of a lender on whether a detached structure serves as a residence. The Agencies believe the lender is in the best position to consider all the facts and circumstances involving a detached structure securing a loan. As the agencies stated in the preamble to the final rule issued in July, there is no duty to monitor the status of a detached structure following the lender's initial determination. A lender must re-examine the status of a detached structure upon a triggering event: making, increasing, renewing or extending a loan. Mary Alice Donner will now discuss the next major provision of the rule, the escrow requirement.

MARY ALICE DONNER – ESCROW REQUIREMENTS

Thank you, Vivian. Slide 10 summarizes the new escrow requirements for the recent final rule. While the Biggert-Waters Act changed the escrow requirements, HFIAA further amended these changes in March of 2014. As required by HFIAA, this final rule requires a regulated institution, or a servicer acting on its behalf, to escrow all premiums and fees for flood insurance for any designated loan secured by residential improved real estate, or a mobile home, that is made, increased, extended or renewed on or after January 1, 2016. Additionally, these premiums and fees would be payable with the same frequency as payments on the loan, for the duration of the loan, unless the loan or the lender qualifies for an exception. Lastly, institutions also should be aware of the procedures, to ensure loans that close after January 1, 2016 will have an escrow account for flood insurance. For example, loan applications received prior to January 1, 2016 might not close before that date. The statute specifically and clearly applies the escrow requirement to loans that experience a triggering event on or after January 1, 2016. Lenders should evaluate whether a loan application submitted prior to January 1, 2016 may close on or after January 1, 2016 and should structure those transactions accordingly.

Slide 11 lays out the first of several statutory exceptions to the escrow requirement. The Biggert-Waters Act provided an exception for small institutions, which was left unchanged by HFIAA. This exception applies if: the institution has total assets of less than $1 billion; and, on or before July 6, 2012 the institution was not required under federal or state law to deposit taxes, insurance premiums, fees or any other charges into an escrow account for the entire term of any loan secured by the residential improved real estate or mobile home; and the institution did not have a policy consistently and uniformly requiring the deposit of taxes, insurance premiums, fees or any other charges in an escrow account for a loan secured by residential improved real estate or a mobile home.

Paull Gibbs will now discuss how the final rule defines a small lender.

PAUL GIBBS –ESCROW REQUIREMENT – SMALL LENDER EXEMPTION

Thanks, Mary Alice. In the final rule, the Agencies implemented the statutory small lender exception to the escrow requirement, with some clarifications. For instance, the Biggert-Waters Act did not specify a point in time to measure the asset size of an institution to determine whether that institution qualifies for the small lender exception. Under the final rule, a financial institution may qualify for the exception if it has total assets of less than $1 billion as of December 31 in either of the two prior calendar years.

Slide 12 provides two examples to demonstrate the small lender exception. Let's say Lender A has assets of $998 million on December 31, 2014 and on December 31, 2015 it had assets of $1.01 billion. Since the lender did not have assets of at least $1 billion as of each of these two years, for both of these two years, therefore, in this example, Lender A may qualify for the exception in 2016. In a different example, let's say Lender B has assets of $1.01 billion on December 31, 2015 and $1.02 billion on December 31, 2016. Since both of these amounts are in excess of $1 billion, Lender B does not qualify for the exception in 2017. It's important to note that while the asset size threshold can change over time, the other part of the small lender exception—that is whether or not an institution was required by federal or state law to escrow taxes for insurance, or had a policy to escrow taxes or insurance—is fixed in time, as Mary Alice discussed a few moments ago, on July 6, 2012.

If we now look to slide 13, this slide contains information regarding the transition requirements for the small lender exception. These transition requirements help financial institutions determine how the escrow requirements apply to them if they have a change in status. Under the final rule, a financial institution must escrow flood insurance premiums and fees for any loans made, increased, extended or renewed on or after July 1 of the succeeding calendar year after it has a change in status. For example, let's say the institution qualifies for the small lender exception in 2016, but has assets of $1 billion or more as of December 31, 2016 and as of December 31, 2017. This institution will be required to begin escrowing for any loans made, increased, extended or renewed on or after July 1, 2018. I would now like to turn the presentation over to Rhonda Daniels, who will go over some other exceptions to the escrow requirement.

RHONDA DANIELS – ESCROW REQUIREMENT – LOAN-RELATED EXEMPTIONS

Thanks, Paul. Slide 14 lists the loan-related exceptions to the escrow requirements. The final rule adopts these additional exceptions to the escrow requirements as provided in HFIAA.

The first exception is for a loan that is an extension of credit primarily for a business, commercial or agricultural purpose, even if it is secured by residential real estate.

The second exception is for a loan in a subordinate position to a senior lien, secured by the same property for which adequate flood insurance is being provided.

The third exception is for property covered by a flood insurance policy that is provided by a condominium, cooperative, or homeowners' association. Under this exception, the property must meet three factors. First, the property must be covered by a flood insurance policy that meets the mandatory flood insurance purchase requirement. Second, the policy must be provided by the condominium association, cooperative homeowners' association, or other applicable group. And third, the applicable group must pay the premium as a common expense. This exception would include instances when the property is covered by a Residential Condominium Building Association Policy—otherwise known as an RCBAP—that meets the mandatory flood insurance purchase requirement, including coverage for the proper amount. If the amount of the policy purchased by the condominium association, cooperative homeowners' association or other applicable group is insufficient to meet the mandatory flood insurance purchase requirement, the lender must require the borrower to obtain a supplemental dwelling policy to cover the deficiency. In this case, the Agencies expect the financial institution to escrow the premiums and fees for the supplemental policy, unless the small lender exception applies. For example, if a condominium association purchases an RCBAP for a private flood insurance policy for less than the amount of insurance required by the mandatory purchase requirement, the borrower needs to obtain a dwelling policy for supplemental coverage. If the borrower is required to obtain a dwelling policy at the time the loan is made, increased, extended or renewed, the financial institution must escrow the premiums and fees for such policy.

The other exceptions from the escrow requirement are for home equity lines of credit, nonperforming loans, and loans for terms no longer than 12 months. The final rule clarifies that the nonperforming loans exception applies to loans that are 90 or more days past due. The loan remains nonperforming until it is permanently modified or until the entire amount past due—including principal, accrued interest, and penalty interest incurred as a result of the past due status—is collected or otherwise discharged in full.

The final rule also clarifies that if a financial institution determines that a loan no longer qualifies for one of these loan exceptions, the institution must begin escrowing as soon as reasonably practicable. Therefore, the final rule has adopted all seven of the statutory exceptions to the escrow requirements, from the small lender exception in the Biggert-Waters Act to the other loan-related exceptions provided in HFIAA.

Sarah Chung will now discuss the notice requirement.

SARAH CHUNG – ESCROW REQUIREMENTS – NOTICE REQUIREMENTS

Thanks, Rhonda. Moving on to slide 15, I will discuss the notice requirements regarding escrow. To minimize the burden on financial institutions and to ensure that borrowers receive the notice at the proper time, the lender or servicer acting on its behalf must provide a notice of the escrow requirement with or in the Notice of Special Flood Hazards. Under the final rule, the revised sample form of notice that includes the escrow notice is provided in Appendix A of each agency's regulation. Financial institutions are expected to use language substantially similar to the model clauses for escrow in the revised sample notice. In addition, the final rule clarifies that lenders must provide the escrow notice in connection with any excepted loan that could lose its exception during the term of the loan. Borrowers will then become aware of the escrow possibility.

Lastly, HFIAA requires certain language to be included in the RESPA Special Information Booklet[1], which the CFPB revised earlier this year. However, as requested by commenters, the Agencies' final rule also amended the Notice of Special Flood Hazards to include the same language. This language states that borrowers may still wish to maintain flood insurance, even if it is not required, and that lenders may still require a borrower to obtain flood insurance to protect the borrower's home.

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[1] The CFPB has issued an updated version of the home buying information booklet (also known as the special information or settlement cost booklet) required under the Real Estate Settlement Procedures Act (RESPA) and Truth in Lending Act (TILA). The new booklet is entitled "Your home loan toolkit: A step-by-step guide." (The booklet it replaces is entitled "Shopping for Your Home Loan: Settlement Cost Booklet.") The new booklet or Toolkit is designed to be used with the new TILA/RESPA integrated disclosures required to be provided for applications received on or after October 3, 2015. It is available at www.cfpb.gov and https://bookstore.gpo.gov/products/sku/048-013-00009-1.

Turning to slide 16 now, I will now discuss the option to escrow requirements. Under HFIAA and the final rule, a regulated lending institution must offer, and make available to borrowers, the option to escrow flood insurance premiums and fees for loans that are outstanding as of January 1, 2016. Financial institutions must provide the option to escrow notice to borrowers by June 30, 2016. A model clause for the notice of the option to escrow is provided in Appendix B of each agency's regulation.

Now moving on to slide 17, this provides more information about the option to escrow. For instance, a regulated lending institution that no longer qualifies for the small lender exception also must provide a notice of the option to escrow and must do so by September 30th of the first calendar year in which it has a change in status. The financial institution must begin escrowing as soon as reasonably practicable after receiving a borrower's request to escrow.

Now let's go through an example of how this optional escrow provision would affect a lender that no longer qualifies for the small lender exception. Suppose a loan is made on March 16, 2016 by a financial institution that qualifies for the small lender exception. If the lender no longer qualifies for the exception as of January 1, 2018, the lender has to escrow flood insurance premiums and fees for loans made, increased, extended or renewed on or after July 1, 2018. Under this example, the borrower of the loan made on March 1, 2016 now has a lender with the capability to escrow flood insurance premiums and fees on July 1, 2018. Consequently, under the final rule, the borrower must be provided with the option to escrow. In this case, the lender is expected to provide a notice informing the borrower of the option to escrow by September 30, 2018.

The final rule does not require that the option to escrow notice be provided in conjunction with any other disclosure or that it be segregated from other information provided to the borrower. Financial institutions may choose whether to provide a separate notice or add it to any other disclosure the lender provides the borrower, such as a periodic statement.

Lastly, all these escrow requirements and related notice requirements will be effective January 1, 2016.

Alex Cheng will now discuss the force placement provisions.

ALEX CHENG – FORCE PLACEMENT PROVISIONS

Thanks, Sarah. On slide 18 let's look at the force placement provisions. The Biggert-Waters Act amended the Flood Disaster Protection Act in several ways. First, to clarify that lenders or servicers have the authority to charge a borrower for force-placed flood insurance premiums or fees incurred for coverage, beginning on the date on which the borrower's flood insurance coverage lapsed or did not provide a sufficient coverage amount. Second, to require the lender or servicer, within 30 days of receiving a confirmation of a borrower's existing flood insurance coverage, to do two things: (1) notify the insurance provider to terminate any force-placed insurance; and (2) refund to the borrower all force-placed insurance premiums and any related fees paid for by the borrower during any period of overlap between the borrower's policy and the force-placed policy. And last, to require the lender or servicer to accept as confirmation of a borrower's existing flood insurance policy a declarations page that includes the existing flood insurance policy number and the identity and contact information for the insurance company or agent.

These force placement provisions became effective upon enactment of the Biggert-Waters Act in July 2012. The final rule, published in the *Federal Register* in July, incorporated these requirements into our respective flood insurance regulations.

A few things to note here: In the Supplementary Information, the final rule provides guidance on these forced placement provisions. As the term "lapsed" is used with respect to charging borrowers for force-placed insurance, the Agencies have determined that the date on which the flood insurance coverage "lapsed" is the expiration date provided by the insurance policy, or the date the flood insurance policy is canceled.

On assessing a borrower for force-placed insurance premiums, an institution that force-places flood insurance, beginning on the day the borrower's insurance policy lapsed, may charge a borrower for the force-placed insurance as of the day of the lapse. This means that the institution could bill the borrower when it force places the policy, or it could wait to bill the borrower at a later date, such as after the notice period expires. As a practical matter, some institutions may wait 45 days to bill the borrower for insurance premiums to avoid the administrative costs of having to refund for any overlap period.

If an institution, despite its monitoring efforts, discovers at some point a situation where there is insufficient insurance coverage, the institution may charge back to the date of insufficient coverage if the institution has purchased a policy that covers the property for flood loss and that policy was effective as of the date of the insurance coverage. However, if the institution must purchase a new policy to force place insurance upon discovery of insufficient coverage, the institution may not charge back to the date of lapse or insufficient coverage, because the policy did not provide coverage for the borrower prior to purchase.

One final note: Institutions have asked questions about the refund requirements, and a common question is whether banks have to refund all overlapping insurance premiums and fees if evidence of the borrower's flood insurance is not provided to the bank on a timely basis. The answer is, Yes. We understand that confirmations of the existing flood insurance coverage may be received by the bank at different times, which could result in refunding insurance premiums and fees for extensive overlap periods. However, the Biggert-Waters Act makes clear that a lender is required to refund any premiums and fees a borrower has paid for which the borrower provides sufficient documentation of overlapping coverage.

I would now like to turn things over to Judy Graham to discuss private insurance.

JUDY GRAHAM – PRIVATE FLOOD INSURANCE

Thank you, Alex. Looking at slide 19, another key change resulting from the Biggert-Waters Act concerns the mandatory acceptance of private flood insurance, which is highlighted on slide 19. The Biggert-Waters Act amended the mandatory purchase requirement of the Flood Disaster Protection Act to require a financial institution to accept a private insurance policy as satisfaction of the mandatory purchase requirement if the coverage provided by the private flood insurance meets the standards specified in the federal flood statutes. The private flood insurance provision requires a financial institution to accept a private flood insurance policy if it meets several criteria, including among others: that the policy is issued by an insurance company that is licensed, admitted, or otherwise approved to engage in the business of insurance in the state in which the insured building is located (or is recognized as a surplus lines insurer); provides flood coverage at least as broad as the coverage provided by a standard flood insurance policy under the National Flood Insurance Program; and includes a mortgage interest clause similar to the clause contained in the standard flood insurance policy. These provisions are not yet in effect, and will not be in effect until the Agencies issue a final rule implementing them. Staff is working together to complete a separate rule-making on private flood insurance. Of note is that there is some legislative activity in Congress that could amend the criteria in the definition of private flood insurance which, if it happens, would require the agencies to consider it before completing its rulemaking.

Moving on to slide 20, the agencies have consistently advised both in their regulations dealing with the Notice of Special Flood Hazards and through interagency guidance—including the interagency "Questions and Answers on Flood Insurance"—that flood insurance is available from private insurers and that institutions can accept private flood insurance policies under certain circumstances, including private flood insurance policies that have the same level of coverage as the standard flood insurance policy issued under the National Flood Insurance Program.

Slides 21 through 23 provide information about useful resources, such as references to the statutes and regulations, including the recently published final rule, guidance from our agencies, and materials from FEMA.

Now I'll turn things back over to Lanette for the question and answer portion of our presentation.

LANETTE MEISTER – QUESTIONS AND ANSWERS

Great, thanks Judy and everyone. I want to thank everyone who submitted questions for us in advance of the call. They all cover really important points, so let's get right to them.

We're going to take a series of questions having to do with the escrow provisions first. The first question is:

QUESTION 1 - IF A LENDER WAS REQUIRED TO ESCROW FOR TAXES AND HAZARD INSURANCE UNDER THE HIGHER-PRICED MORTGAGE LOAN—OR HPML—RULES ON OR BEFORE JULY 6, 2012, IS SUCH A LENDER, WHO OTHERWISE QUALIFIES FOR THE SMALL LENDER EXCEPTION, REQUIRED TO ESCROW THE PREMIUMS AND FEES FOR FLOOD INSURANCE?

I'm going to turn to Vivian Wong. Would you like to answer this question for us, Vivian?

Vivian Wong:

Sure, I can take it. So, the answer to the question is "no." The Biggert-Waters Act provides that a small lender is eligible for the exemption only if on or before the date the Biggert-Waters Act was enacted, the lender (1) was not required under federal or state law to deposit taxes, insurance premiums, fees or any other charges in an escrow account for the entire term of any loan secured by residential improved real estate or a mobile home, and (2) did not have a policy of consistently and uniformly requiring the deposit of taxes, insurance premiums, fees or other charges in an escrow account for any loans secured by residential improved real estate or a mobile home. With respect to an HPML, federal law in effect on or before the Biggert-Waters Act's date of enactment permitted a borrower to request cancellation of the escrow rather than have it apply to the entire term of the loan. Therefore, HPML escrow requirements should not result in the loss of the escrow exemption for a small lender that made an HPML-covered loan prior to enactment of the Biggert-Waters Act, because the lender was not required under federal law to escrow for the entire term of the loan. In addition, if a lender required escrow for an HPML solely to comply with federal law, a lender complying with that law did not have its own separate policy of consistently and uniformly requiring the escrow.

Lanette Meister:

Alright, thank you, Vivian.

Vivian Wong:

Sure.

Lanette Meister:

Alright, our second escrow question:

QUESTION 2 – A LENDER MUST ESCROW FOR FLOOD INSURANCE IF IT HAS MORE THAN $1 BILLION IN TOTAL ASSETS. DOES THAT MEAN IT NO LONGER QUALIFIES FOR THE EXEMPTION FROM THE HPML ESCROW REQUIREMENT ON ANY OF ITS LOANS? DOES THIS MEAN THAT A NON-FLOOD-ZONE HPML BORROWER MUST HAVE AN ESCROW ONLY BECAUSE THE LENDER IS ALSO LENDING TO A FLOOD-ZONE BORROWER, FOR WHOM AN ESCROW IS REQUIRED?

So, I'm going to ask Margaret Hesse from the OCC to answer this question for us. Margaret?

Margaret Hesse:

Thanks, Lanette. This question addresses the interplay between the small lender exception in the flood insurance rules and CFPB's regulation Z requirements for higher-priced mortgage loans. Section 1026.35(b)(2)(iii) of Regulation Z states that an HPML covered by a first lien must have an escrow account established for taxes and insurance. There is a limited exemption from this escrow requirement for small creditors in rural or underserved areas. The CFPB recently amended the definitions of small creditor and rural and underserved areas, effective January 1, 2016, the same effective date as the agencies' new escrow rules. Under the CFPB's newly revised rule, a lender must satisfy all of the following criteria to qualify for the small lender exemption: (1) it makes more than half of its first lien mortgages in rural or underserved areas; (2) together with its affiliates, it has originated 2,000 or fewer first lien mortgages during the preceding calendar year; (3) together with its mortgage affiliates, it has an asset size of less than $2 billion; and (4) together with its affiliates, it does not escrow for any mortgage it or its affiliates currently services. If any one of these factors is not satisfied, the exemption is not available.

Under the flood insurance rules, if a lender exceeds $1 billion in assets, the lender would have to escrow flood insurance premiums and fees for a loan secured by residential improved real estate located in a flood hazard zone. This would mean that a lender would no longer be able to satisfy one of the criteria for the HPML exemption for small creditors in rural or underserved areas. That is, together with its affiliates, it may not escrow for any currently serviced mortgage. Consequently, a lender with assets exceeding $1 billion that must escrow flood insurance premiums and fees for any of its loans would be required to set up an escrow for any first lien HPML that it might make. This would be true even if the lender and its affiliates had less than $2 billion in assets.

Lanette Meister:

Great, thanks. Thanks so much for that answer. Okay, our third escrow question has to do with construction-permanent loans:

QUESTION 3 – DO CONSTRUCTION-PERMANENT LOANS QUALIFY FOR THE 12 MONTH EXCEPTION FROM ESCROW IF ONE PHASE OF THE LOAN IS FOR 12 MONTHS OR LESS?

I'll turn to Rhonda Daniels to answer this question for us, if you will please, Rhonda?

Rhonda Daniels:

Thanks, Lanette. The answer to the question is, Generally, no. Construction-permanent loans—or CP loans—are loans that have a construction phase of approximately one year before the loan converts into permanent financing. During the construction phase, the loan is typically interest-only, so the borrower does not start paying principal until the permanent phase. After the construction phase, the borrower generally comes in to sign papers to start the permanent phase, but it's not a true closing. Given that construction-permanent loans are generally 20 to 30-year loan terms, however, a construction-to-permanent loan with a loan term exceeding 12 months does not qualify for the 12 month exception from escrow, even if one phase of the loan is for 12 months or less.

Lanette Meister:

Great, thank you, Rhonda. Our fourth question:

QUESTION 4 – ALTHOUGH A LENDER IS NOT REQUIRED TO MONITOR WHETHER A SUBORDINATE LIEN LOAN MOVES INTO A FIRST LIEN POSITION FOR THE PURPOSE OF THE MANDATORY ESCROW REQUIREMENT, IF THE LENDER BECOMES AWARE THAT THE SUBORDINATE LIEN EXCEPTION NO LONGER APPLIES, WHEN MUST THE LENDER BEGIN TO ESCROW?

Sarah, would you be happy to take that question for us?

Sarah Chung:

Sure, thanks, Lanette. As stated in the preamble to the final rule, when a lender determines that a subordinate lien exception no longer applies, then the lender must begin escrowing flood insurance premiums and fees. Lenders should ensure that the subordinate lien's loan documents permit the lender to require an escrow if the loan takes a first lien position. The preamble to the final rule also clarifies that if a lender or its servicer determines at any time during the term of a designated loan that any exception does not apply, then the lender or its servicer shall require the escrow of all flood insurance premiums and fees as soon as reasonably practicable.

Lanette Meister:

Great, thank you, Sarah.

Sarah Chung:

Sure.

Lanette Meister:

Our fifth question, also having to do with escrow:

QUESTION 5 – IS AN INSTITUTION DISQUALIFIED FROM THE SMALL LENDER EXCEPTION IF IT IS REQUIRED TO COLLECT ESCROWED FUNDS ON A MORTGAGE LOAN ON BEHALF OF A THIRD PARTY, OR FOR A LOAN TO BE SOLD ON THE SECONDARY MARKET?

Navid Choudhury from the FDIC, would you be willing to answer that question for us?

Navid Choudhury:

Sure, Lanette. To qualify for the small lender exception, one requirement is the institution must not have had a policy on or before the date the Biggert-Waters Act was enacted of consistently and uniformly requiring the deposit of taxes, insurance premiums, fees, or any other charges in an escrow account for any loans secured by residential improved real estate or a mobile home. For mortgage loans where the institution collected escrow funds at closing, and servicing of the loan was maintained by the institution, the institution would not qualify for the exception because the institution would have established an individual escrow account for the loan it will then service. For mortgage loans where the institution collected the escrow funds at closing at the behest of a third party and then transferred the escrow funds to the third party servicing that loan, the institution would be able to qualify for the small lender exception, provided the institution did not establish an individual escrow account, and it transferred the funds to the other party expeditiously. A small lender must also satisfy the other requirements for the exception. But, because no individual escrow account would have been established for the loan whose servicing rights were to be transferred pursuant to a third party's requirement, the institution would not have had a policy of consistently and uniformly requiring the deposit of funds in an escrow account.

Lanette Meister:

Alright, thank you, Navid.

Our sixth question, also on escrow.

QUESTION 6 – IS A LENDER ELIGIBLE FOR THE SMALL LENDER EXCEPTION IF IT OFFERS ESCROW ACCOUNTS ONLY UPON A BORROWER'S REQUEST?

I'll turn to Paul Gibbs for this one. Paul, would you be willing to answer it for us?

Paul Gibbs:

Absolutely, Lanette. As required by the Biggert-Waters Act and the final rule, the small lender exception does not apply if the financial institution had a policy consistently and uniformly requiring the deposit of taxes, insurance premiums, fees, or any other charges in an escrow account for a loan secured by residential improved real estate or a mobile home. In the preamble to the final rule, the agencies stated that maintaining escrow accounts based on a borrower's request does not constitute a policy of uniformly or consistently requiring escrow. Therefore, if a financial institution is only offering escrow accounts as a result of requests from borrowers, the agencies believe this does not constitute a consistent or uniform policy of requiring escrow.

Lanette Meister:

Terrific, thank you, Paul.

Paul Gibbs:

Absolutely.

Lanette Meister:

Here's a question about our small lender exception:

QUESTION 7 - IS THE $1 BILLION SMALL LENDER EXCEPTION FOR THE MANDATORY ESCROW OF FLOOD INSURANCE PREMIUMS AT THE LENDING INSTITUTION LEVEL, OR AT THE BANK HOLDING COMPANY LEVEL?

And Vivian is our bank holding company supervisor in the room. Would you be willing to answer that question for us, please?

Vivian Wong:

Sure, I can handle that. So, by its own terms, the small lender exception to the flood insurance escrow regulatory requirement applies to lenders rather than holding companies. Therefore, the $1 billion requirement is calculated based on the assets held at the lending institution level, rather than at the holding company level.

Lanette Meister:

Terrific, thank you. Alright, another question that we've had about escrow is regarding its association with the force-placed insurance. The question is:

QUESTION 8 – ARE WE REQUIRED TO ESCROW FORCE-PLACED INSURANCE?

Margaret Hesse, would you be willing to answer that question for us?

Margaret Hesse:

Sure, Lanette, thanks. The answer to that question is, Yes. The rule requires lenders to escrow flood insurance premiums for any residential designated loan made, increased, extended or renewed on or after January 1, 2016 unless the lender or the loan qualifies for an exception from the escrow requirement. The Biggert-Waters Act, as enacted by Congress and as implemented in the Agencies' rules, does not include an exception to the escrow requirement for force-placed insurance.

Lanette Meister:

Thank you, Margaret.

Alright, then, one final question on escrow, and this one—try to stick with me as I lay out the scenario that the questioner asked here. It has to do with notification of borrowers.

QUESTION 9 – THE RULE REQUIRES BANKS TO NOTIFY BORROWERS WITH EXISTING LOANS AS OF JANUARY 1, 2016 OF THE OPTION TO ESCROW, WITH THE NOTICE TO THESE BORROWERS TO BE SENT BY JUNE 30, 2016. WHAT IS THE EXPECTATION REGARDING LOANS THAT MATURE IN CLOSE PROXIMITY TO THAT TIMEFRAME? FOR EXAMPLE, TECHNICAL COMPLIANCE WITH THE REGULATION WOULD MEAN THAT A NOTICE WOULD BE REQUIRED TO BE SENT TO A BORROWER WITH A LOAN THAT MATURES AUGUST 1, 2016. THAT POTENTIALLY IS CONFUSING OR NOT HELPFUL TO THE BORROWER, BUT THE RULE DOES NOT PROVIDE FOR ANY LEEWAY.

Navid, would you be willing to take on this question for us, please?

Navid Choudhury:

Of course, Lanette. The requirement for lenders to notify borrowers of the option to escrow applies to all covered loans outstanding as of January 1, 2016. Due to the statutory requirement that the lender provide this notice, the agencies chose a June deadline to allow lenders sufficient time to prepare and deliver that notice to affected borrowers. While the regulatory deadline for providing that notice is June 30, 2016, lenders may provide that notice at any time before that date. Because the notice is simply informing the borrower of an option that doesn't require action the part of the borrower, the regulation does not provide for any waiver of this notice based on the anticipated maturity of the loan.

Lanette Meister:

Alright, thank you, Navid. Alright, now we'll spend a few minutes talking about some questions that were submitted to us regarding force-placed insurance. The first one is:

QUESTION 10 – IF A BORROWER'S FORCE-PLACED FLOOD INSURANCE IS ABOUT TO EXPIRE, WHAT PROCESS DOES THE LENDER NEED TO USE TO RENEW THE FORCE-PLACED FLOOD INSURANCE COVERAGE?

Alex, since you handled the force-placed portion of our presentation, would you be willing to handle this question?

Alex Cheng:

I'd be happy to. So, the regulations covering force placement practices require the lender to notify the borrower if the lender, and I quote, "determines at any time during the term of the designated loan that the building or mobile home and any personal property securing the designated loan, is not covered by flood insurance, or is covered by flood insurance in an amount less than required." So, in this scenario, the force-placed policy is only about to expire, and has not yet lapsed. So, the property is still sufficiently covered by flood insurance. The text of the regulations does not require additional notification to the borrower when force-placed insurance is due for renewal. When the lender is notified that the force-placed flood insurance policy is about to expire, the lender should follow its normal communication practices with its insurance provider to renew the flood insurance policy on the borrower's behalf, to ensure that flood insurance coverage remains in place. The lender, at its discretion, may notify the borrower that the lender is planning to renew or has renewed the force-placed policy. Such a notification may encourage the borrower to seek its own policy, which may be available for a lower premium amount.

Lanette Meister:

Thank you, Alex. Alright, the next question is:

QUESTION 11 – IS A LENDER PERMITTED TO INCREASE, RENEW OR EXTEND A DESIGNATED LOAN THAT IS CURRENTLY INSURED BY FORCE-PLACED INSURANCE? MORE SPECIFICALLY, IF THE BORROWER IS UNDERGOING A REFINANCE OR A LOAN MODIFICATION, CAN THE LENDER USE THE EXISTING FORCE-PLACED INSURANCE TO MEET THE MANDATORY PURCHASE REQUIREMENT?

Rhonda, would you be willing to handle that one?

Rhonda Daniels:

Sure, thanks, Lanette. When a lender is increasing, renewing or extending an existing loan, the lender is required to provide the Special Flood Hazard Notice, which details the borrower's obligation to obtain a flood insurance policy for any building in a Special Flood Hazard Area securing the loan. At that time, the lender is in an excellent position to encourage the borrower to purchase his or her own policy, likely at a reduced cost to the borrower, prior to the closing of the loan. That said, the lender can use the force-placed insurance to satisfy the mandatory purchase requirement if the borrower does not purchase his or her own policy. The Agencies' flood insurance regulations state that a lender shall not make, increase, extend or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. Assuming the force-placed policy is in effect, and otherwise satisfies the regulatory coverage standards, then that policy may satisfy the mandatory purchase requirement. The term "flood insurance", which is not defined by flood insurance statutes or regulations, is sufficiently broad in scope to include force-placed policies.

Lanette Meister:

Great, thank you, Rhonda. And another question about force placement:

QUESTION 12 – WHAT DOCUMENTATION IS REQUIRED TO SHOW THE RENEWAL OF A FLOOD INSURANCE POLICY?

Mary Alice, would you take that one for us?

Mary Alice Donner:

Well, Lanette, I will give that a try. So, the question is: What documentation is required to show the renewal of a flood insurance policy? Well, the final rule does not specifically address documentation required to show renewal of a flood insurance policy. The rule provides that, for purposes of confirming a borrower's existing flood insurance, a lender must accept from the borrower an insurance policy declarations page that includes the existing flood insurance policy number and the identity of and contact information for the insurance company or its agent. In the preamble to the rule, the Agencies have declined to require additional information be included on the declarations page in order to be accepted. Although there's no discussion of renewals in the rule, a policy declarations page that includes the existing flood insurance policy number and the identity of and contact information for the insurance company or its agent would be sufficient. It also would be acceptable, although not required by the rule, to follow FEMA Bulletin W-13013, as referenced in footnote [69] of the Final Rule[2], and that FEMA bulletin discusses the acceptable forms of evidence of insurance.

Lanette Meister:

Thank you, Mary Alice. Alright, another forced-placement question:

QUESTION 13 – MAY A LENDER COMMENCE A FORCE-PLACED INSURANCE POLICY ON THE DAY THE PREVIOUS POLICY EXPIRES? OR, MUST THE NEW POLICY BEGIN ON THE DAY AFTER?

Margaret Hesse, would you be willing to take that one for us?

Margaret Hesse:

Sure, thank you, Lanette. The regulations state, and I quote, "The [regulated financial institution] or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance, including premiums or fees incurred for coverage, beginning on the date on which flood insurance lapsed or did not provide a sufficient coverage amount." A lender, however, may not require the borrower to pay for double coverage. The regulation requires the regulated lending institution or its servicer to "refund to the borrower all premiums paid by the borrower for any insurance purchased by the [regulated lending institution] or its servicer [under the forced-placement provisions] during any period during which the borrower's flood insurance coverage and the insurance coverage purchased by the [regulated lending institution] were each in effect…" So, in this case, if the previous policy expires at midnight at the end of day one, the lender's new force-placed policy should not begin to provide coverage until just after midnight at the beginning of day two. In other words, 12:01 AM on day two. If the lender did force-place on day one, and the policy provided overlapping

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[2] Footnote 68 was referenced in the discussion, however footnote 69 is the correct footnote. The footnote states the following:

"FEMA Bulletin W-13013, issued March 19, 2013, reiterates that the NFIP rules and regulations do not allow the use of temporary declarations pages as evidence of insurance. The Bulletin refers to the General Rules section of the Flood Insurance Manual which provides rules regarding acceptable forms of evidence of insurance:

> A copy of the Flood Insurance Application and premium payment, or a copy of the declarations page, is sufficient evidence of proof of purchase for new policies. The NFIP does not recognize binders. However, for informational purposes only, the NFIP recognizes certificates or evidences of flood insurance, and similar forms, provided for renewal policies if the following information is included: the policy form/type, term, and number; insured's name and mailing address; property location; current and rated flood risk zone; grandfathering status; mortgagee name and address; coverage limits; deductibles; and annual premium."

The Final Rule can be accessed at www.federalreserve.gov/newsevents/press/bcreg/bcreg20150622a1.pdf.

coverage on day one, the lender could not charge the borrower for the period of overlapping coverage on day one.

Lanette Meister:

Great, thanks for that example.

Margaret Hesse:

Sure.

Lanette Meister:

Alright, the next participant asks:

QUESTION 14 – ARE INSTITUTIONS REQUIRED TO HAVE IN PLACE SOME TYPE OF LIFE-OF-LOAN MONITORING TO SEE FLOOD MAP CHANGES? THEY NOTE THAT THEY'VE SEEN BANKS THAT DON'T HAVE IT, AND THEN THEY CLAIM TO HAVE A "LACK OF KNOWLEDGE" ON MAP CHANGES, AND THE PARTICIPANT NOTES TWO POTENTIAL IMPACTS: (1) BORROWERS PAYING FOR COVERAGE THEY'RE NO LONGER REQUIRED BY LAW TO HAVE, AFTER THEY ARE MAPPED OUT OF THE ZONE, AND ALSO (2) BORROWERS MAPPED INTO FLOOD ZONES WITH NO COVERAGE BEING REQUIRED BY THE BANK.

So, Paul, would you handle this question for us?

Paul Gibbs:

Sure, Lanette. While there's no explicit duty to monitor flood insurance coverage over the life of the loan, for purposes of safety and soundness, regulated lending institutions should monitor the continuous coverage of flood insurance for the building or mobile home and any personal property securing a designated loan. Such a practice will ensure that institutions complete the force-placement of flood insurance in a timely manner upon lapse of the policy, and that there is continuous coverage to protect both the borrower and the institution. If an institution, despite its monitoring efforts, discovers a policy with insufficient coverage—for example, due to a remapping—the institution may charge back to the date of insufficient coverage, provided the institution has purchased a policy that covers the property for flood loss, and that policy was effective as of the date of such insufficient coverage.

Lanette Meister:

Perfect, thank you, Paul.

Paul Gibbs:

You're welcome.

Lanette Meister:

So, I see that we're at the end of our long hour. I did want to have us take a couple of questions having to do with detached structures. So, we'll try to fit in responses to a few more questions. I'm mindful of the participants' time on the webinar, so please stay with us if you can, but if you need to leave us, just a reminder to you that you'll be able to hear the remaining responses on the *Outlook Live* archive of this webinar.

So, moving to the questions about detached structures:

QUESTION 15 – DOES THE LENDER HAVE TO TAKE A SECURITY INTEREST IN THE PRIMARY RESIDENTIAL STRUCTURE FOR DETACHED STRUCTURES TO BE ELIGIBLE FOR THE DETACHED STRUCTURE EXEMPTION? AND THEN THIS PARTICIPANT GIVES US AN EXAMPLE: SUPPOSE THE HOUSE ON A FARM IS NOT COLLATERAL, BUT ALL OF THE OUTBUILDINGS, INCLUDING THE BARN, EQUIPMENT STORAGE SHED, AND SILO—WHICH ARE ALL USED FOR FARM PRODUCTION—AND A DETACHED GARAGE—WHERE THE HOMEOWNER KEEPS HIS CAR—ARE TAKEN AS COLLATERAL. MAY THE LENDER APPLY THE DETACHED STRUCTURE EXEMPTION TO THE OUTBUILDINGS?

Sarah, will you handle that question for us?

Sarah Chung:

Sure, Lanette. The lender does not have to take a security interest in the primary residential structure for detached structures to be eligible for the exemption. But, the lender needs to evaluate the uses of detached structures to determine if they are eligible. The Agencies have stated that "residential property" in the detached structure exemption should apply only to structures for which there is a residential use, and not to structures for which there is a commercial, agricultural or other business use. In this example, only the garage is serving a residential use, so it could qualify for the exemption. The barn, equipment storage shed and silo, which are used for farm production, would not qualify for the exemption.

Lanette Meister:

Thanks for that clarification, Sarah.

Sarah Chung:

Sure.

Lanette Meister:

Our next detached structures question:

QUESTION 16 – WILL DETACHED STRUCTURES STILL REQUIRE A FLOOD HAZARD DETERMINATION TO BE PERFORMED, EVEN THOUGH COVERAGE IS NOT REQUIRED?

Mary Alice, will you answer that question for us?

Mary Alice Donner:

Sure, Lanette. The answer is, yes. Because a flood hazard determination is often needed to determine the number and types of structures on the property, conducting a flood hazard determination remains necessary to ensure compliance with the flood insurance requirements.

Lanette Meister:

Great. Thank you, Mary Alice. Let's just take one final question before we wrap up here.

QUESTION 17 – IF A LENDER SENDS THREE NOTICES PRIOR TO EXPIRATION TO ITS BORROWER THAT THEIR FLOOD INSURANCE POLICY IS ABOUT TO EXPIRE, THEN, ON THE DAY THE POLICY EXPIRES, THE BANK FORCE-PLACES INSURANCE, IS THIS PRACTICE ACCEPTABLE?

Alex, will you handle that one?

Alex Cheng:

Sure. The Flood Disaster Protection Act specifically provides that the lender or servicer for a loan must send a notice upon its determination that the collateral property securing the loan is either not covered by flood insurance or is covered by such insurance in an amount less than the amount required. Although a lender may send notices prior to the expiration date as a courtesy, the lender or servicer is still required to send notice upon determining that the flood insurance policy actually has lapsed in order to meet the statutory requirement. The lender may then place insurance on the date of the lapse.

Lanette Meister:

Great, thank you, Alex.

Alright, well we have run a little bit over our time. Thank you everyone for staying with us. Mike, shall I turn it back over to you for a bit of a wrap-up?

MICHAEL VANDER VELDE – WRAP-UP

Very good. Thank you very much. I just want to let you know, we are going to send out a survey in just a moment. We're also going to push it out through the webinar tool, so please just take a moment to fill it out in either space.

Thank you all for joining us today. A special thank you to our presenters for all their hard work on this. We did get a ton of questions from you folks, and we will be taking those questions. Most of them will get a response in some further publications coming out later. With that said, remember to check the www.consumercomplianceoutlook.org website for information about this session and others. Have a great day, everybody. We'll talk to you next time.

[event concluded]