Federal Agencies Require Escrow for Flood Insurance Beginning January 2016

Five federal financial agencies this week finalized a rule requiring lenders to escrow flood insurance premiums for homes in flood zones, and exempting homeowners from a requirement to buy flood insurance for detached structures.

Highlights of the agencies' action:

- Banks and mortgage servicers must escrow for flood insurance premiums on mortgages made, increased, extended or renewed after Jan. 1, 2016, for customers in special flood hazard areas – as designated on Federal Emergency Management Agency maps.

- Lenders are required to offer the option to escrow for customers with pre-existing loans by June 30, 2016.

- The rule applies to residential home mortgages and mobile home mortgages.

- Limited exceptions apply for situations including some condominiums, home equity loans and commercial credit, and financial institutions with small-bank exceptions.

- Homeowners are not required to insure certain detached structures not used as a residence, such as storage sheds or garages. However, the rule states that lenders can require flood insurance on these structures to protect the collateral securing the loan.

The rule is from five federal agencies with financial oversight responsibilities: the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the National Credit Union Administration. The rule implements provisions of the 2014 Homeowner Flood Insurance Affordability Act, which was designed to address concerns resulting in some of the provisions included in the Biggert-Waters flood insurance reform law of 2012.

The agencies also clarified that under Biggert-Waters, financial institutions have the authority to charge borrowers for the cost of lender-placed flood insurance coverage starting on the date the borrower's coverage lapses or becomes insufficient.

The federal agencies' 189-page publication on the new rule can be found here.