1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
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Virginia E. O'Neill
Senior Counsel
Center for Regulatory Compliance
Phone: 202-663-5073
Fax: 202-828-5052
voneill@aba.com

By electronic delivery

May 20, 2008

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 1-5
Washington, D.C. 20219
regs.comments@occ.treas.gov

Regulation Comments,
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW.
Washington, DC 20552
Attention: No. 2006–19
regs.comments@ots.treas.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
regs.comments@federalreserve.gov

Gary K. Van Meter, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102- 5090
regcomm@fca.gov

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Comments@FDIC.gov

Mary F. Rupp,
Secretary of the Board
National Credit Union Administration
1775 Duke Street, Alexandria, Virginia 22314–3428
regcomments@ncua.gov

Re: Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance; OCC Docket OCC-2008-0002; FRB Docket No. op-1311; FDIC RIN No. 3064-ZA00; OTS Docket OTS-2008-001; FCA RIN No. 3052-AC46; NCUA RIN no. 3133-AD41

Ladies and Gentlemen:

The American Bankers Association (ABA)[1] respectfully submits its comments on the Loans in Areas Having Special Flood hazards; Interagency Questions and Answers Regarding Flood Insurance (the Questions and Answers) [2] proposed by the Office of

1 The American Bankers Association brings together banks of all sizes and charters into one association. The ABA works to enhance the competitiveness of the nation's banking industry and to strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

2 73 Fed.Reg. 15259 (March 21, 2008)

the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Farm Credit Administration, and the National Credit Union Administration (collectively, the Agencies).

Summary of Comment

ABA welcomes the Agencies' proposed Questions and Answers as an effort to address the important goal of promoting the consistent interpretation, application, and examination of bank regulatory obligations arising from implementation of the National Flood Insurance Reform Act of 1994 (the Act).[3] The proposed Questions and Answers will help many banks understand and meet their compliance obligations.

ABA believes, however, that the Agencies must guard against the temptation to use the Questions and Answers to make substantive changes to the fundamental regulatory obligations established by Congress. In particular, ABA and its members oppose the Agencies' announcement that a bank's failure to resolve a flood zone discrepancy constitutes a compensable violation of the Act. ABA believes this announcement as well as other statements of regulatory expectation inserted into the Questions and Answers improperly expand a bank's duty and liability for ensuring the mandatory purchase of flood insurance far beyond the statutory triggers established by Congress.

ABA submits its comments in two parts: a general statement of overriding concerns about the proposed Questions and Answers, and specific comments on individual Questions and Answers or suggestions for additional guidance.

Background and General Concerns

Because flooding is recognized as among the costliest and most devastating disasters in the United States, floodplain management and loss mitigation efforts have been topics of significant and continuing legislative activity by the federal government since the passage of the National Flood Insurance Act of 1968.[4] The 1968 Act created the National Flood Insurance Program (NFIP), a program administered by the Federal Emergency Management Administration (FEMA), and charged by Congress with a dual mandate: the mitigation of flood damage through community floodplain management and the protection of property owners and taxpayers from loss through participation in a federal flood insurance program. Because voluntary participation in the federal flood insurance program was quite limited, the Flood Disaster Protection Act of 1973 established a statutory purchase obligation, requiring the purchase of flood insurance as a condition precedent for a mortgage loan obtained from a federally regulated lending institution on a property in an identified flood prone area. Finally, the National Flood Insurance Reform Act of 1994 strengthened the statutory purchase obligation and required the Agencies to promulgate flood insurance regulations further defining this requirement.

[3] 42 U.S.C. §4030 et seq.
[4] 42 U.S.C. §4001et seq.

The Agencies fulfilled this duty by issuing substantially similar joint final regulations in 1996 (the Regulations).[5] Despite the fact that the Regulations provide the only regulatory guidance in an important and rather technical area, the Regulations are brief, and the relevant language is quite limited. Indeed, section 339.3, which defines the mandatory purchase requirement, states only—

> A bank 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. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage for the particular type of property under the Act. Flood insurance coverage is limited to the overall value of the property securing the designated loan minus the value of the land on which it is situated.[6]

Despite this limited guidance, the Agencies have consistently insisted on robust flood compliance programs by insured depository lenders. Lacking adequate regulatory guidance, lenders have scrambled to understand the complexities of FEMA's flood plain mapping and the intricacies of NFIP's flood insurance programs in order to establish compliant lending policies and procedures. Over the years financial institutions have directed hundreds of technical questions to the Agencies and/or to FEMA. In 1997, the Agencies responded to these questions with the release of Interagency Questions and Answers Regarding Flood Insurance; however, considerable ambiguity and confusion remain.[7] Clearly, there is a significant need for additional regulatory guidance in this area. ABA supports the efforts of the Agencies to issue updated Questions and Answers.

While generally supportive of the Agencies' effort to provide additional guidance, the ABA urges restraint in this process. Many of the "clarifications" proposed by the Questions and Answers constitute significant substantive changes that should not be effected by regulatory guidance. Moreover, the proposed Questions and Answers evince the continued trend to assign ever increasing responsibility to financial institutions to enforce flood compliance and to ensure the financial viability of the NFIP. ABA respectfully urges the Agencies to recognize that the statutory scheme established by Congress assigned to banks a limited *supporting role* in the larger flood management program administered by FEMA through the NFIP. As will be discussed in greater detail in response to specific proposed Questions and Answers, ABA believes that much of the increased responsibility being imposed on financial institutions is misplaced. The dual goals of ensuring adequate flood insurance

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[5] *See* 61Fed.Reg. 45684 (August 29, 1996). Individual Agency rules are codified at 2 CFR Part 22 (OCC); 12 CFR Part 208 (Federal Reserve); 12 CFR Part 339 (FDIC); 12 CFR Part 572 (OTS); 12 CFR Part 614 (FCA); and 12 CFR Part 760 (NCUA).

[6] 12 CFR Part 339.3(a)

[7] This confusion is demonstrated by the high level of interest in all ABA-sponsored briefings on the subject of flood compliance, the number of flood compliance questions received by the ABA's Center for Regulatory Compliance, and the fact that 26% of the compliance examinations conducted by the Federal Deposit Insurance Corporation in 2007 included significant flood insurance violations.

protection for property owners without overburdening the federal treasury could be more efficiently achieved by keeping the primary responsibility where Congress originally assigned it -- with FEMA and the NFIP.

On a related note, ABA urges the Agencies to avoid the temptation to insert safety and soundness comments into proposed Answers that may have the practical effect of expanding the mandatory purchase requirement imposed by the Act and Regulations. Pursuant to the 1994 Act, Congress gave the Agencies a specific grant of rulemaking authority, stating only that each Agency "shall by regulation direct regulated lending institutions not to make, increase, extend, or renew any loan secured by improved real estate".[8] Accordingly, the Agencies drafted Regulations that are appropriately narrow in scope, mirroring Congress' intent that the only statutory "tripwires" established by the Act arise when a loan is made, increased, extended, or renewed. The failure to ensure that flood insurance has been purchased or is being maintained at each of these tripwires is the only cause for liability under the Act.

Throughout the proposed Questions and Answers, the Agencies acknowledge these tripwires but then insert safety and soundness comments that have the potential to expand a bank's flood compliance obligations significantly. ABA urges the Agencies to recognize that the guidance they provide in the Questions and Answers should be limited by the clear intent of the Act and the Regulations. Although the presence of adequate flood insurance coverage is a factor considered in measuring the safety and soundness of loan operations, these considerations are a part of a separate inquiry unrelated to the question of whether a bank has committed a violation of the mandatory purchase requirement. ABA fears that the insertion of safety and soundness comments in these Questions and Answers may have a tendency over time to expand improperly the mandatory purchase requirement and the scope of the Act's civil money penalty enforcement authority far beyond that intended by Congress.

Specific Comments:

<u>Section I: Determining When Certain Loans are Designated Loans for Which Flood Insurance is Required Under the Act and Regulation</u>

Question 3 addresses whether the purchase of a loan secured by a building or mobile home located in a special flood hazard area (SFHA) in a participating community is a statutory tripwire. The proposed Answer correctly states that a loan purchase is not the making of a loan, and therefore it is not a triggering event. The Answer, however, goes on to state that "safety and soundness considerations may sometimes necessitate such due diligence upon purchase of a loan so as to put the lender on notice of lack of adequate flood insurance." As discussed above, the ABA urges the Agencies to avoid the insertion of comments directed to safety and soundness considerations. Neither the Act nor the Regulations require a flood compliance portfolio review at any time. However, the statement in issue may be interpreted by examiners to mandate, as a "best practice," a due diligence review of purchased loans for flood compliance. Pursuant to that review, a lender's discovery that a loan

[8] 42 U.S.C. §4012a(b)(1)

secured by property located in a SFHA lacks flood insurance could be criticized if the lender did not require the borrower to obtain flood insurance. Alternatively, if a lender refuses to conduct the due diligence review -- relying instead on the statutory scheme pursuant to which the tripwire for the mandatory purchase requirement is the *making, not purchasing,* of a loan-- the lender's flood compliance program may be subject to criticism or unwarranted penalties. The result would be the extension of the mandatory purchase requirement to cover situations not intended by Congress; therefore, ABA urges the Agencies to remove the safety and soundness comment.

Similarly, ABA urges the Agencies to remove the safety and soundness comment from proposed Answer 6. After unequivocally stating that a bank does not have a duty to perform a review of its, or its servicer's, existing loan portfolio for compliance with the flood insurance requirements the Agencies add, "a regulated lender need only review and take action on any part of its existing portfolio for safety and soundness purposes, or if it *knows or has reason to kn*ow of the need for NFIP coverage." As discussed above, the insertion of this kind of comment has the tendency over time to develop into an exam standard for due diligence reviews that are not required by statute or Regulation and to inject unnecessary uncertainty about a bank's legal compliance duties.

Section II: Determining the Appropriate Amount of Flood Insurance Required Under the Act and Regulation

Question and Answer 7 addresses the pivotal question of how to determine the amount of flood insurance required by the Act and Regulations. The formula for the determination appears straightforward, but in practice it has generated considerable confusion. The required amount of flood insurance is the lesser of the outstanding principal balance of a designated loan or the maximum limit of coverage available under the NFIP for the particular type of property. The maximum limit available, in turn, is limited by "the *overall value* of the property securing the designated loan minus the value of the land on which the property is located" (emphasis added).[9] Thus, the key to determining the required amount of flood insurance is to define the term "overall value."

Proposed Answer 7 purports to define "overall value," but it fails to provide adequate clarity. Instead, it equates overall value with an insurance term of art, "insurable value" which it also fails to define except by a general discussion of the fact that some lenders look to hazard insurance to determine insurable value. Adding to this confusion, within Answer 7 and subsequent Questions and Answers, there are references to "repair and replacement cost," but the Agencies never explicitly state that property valuations are to be based on repair or replacement costs, nor do they define this term. Finally, the 2007 Mandatory Purchase of Flood Insurance Guidelines (the Guidelines) includes references to "actual cash value."[10] ABA urges the Agencies to define clearly the terms "overall value," "insurable value," "repair or replacement cost," and "actual cash value" and to provide clear guidance about how financial institutions should determine and document the insurable value of both residential and non-residential properties. Currently, there is significant uncertainty among lenders about whether to rely on hazard insurance or

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[9] 12 C.F.R. §339.3

[10] Federal Emergency Management Agency, *Mandatory Purchase of Flood Insurance Guidelines* 28 (2007)

an appraisal, and there is considerable confusion about how to determine the value of a building's foundation or supporting structure.

In addition to providing these definitions, ABA urges the Agencies to take another step -- to work with FEMA to do away entirely with the valuation problem faced by lenders. In the Guidelines, FEMA acknowledges the confusion that exists and the fact that bankers are ill-equipped to make value determinations suggesting—

> Lenders should seek the assistance of property insurance agents or companies when determining the appropriate flood insurance coverage amounts, as they do for other lines of insurance…Further, agents can help identify and consider the extent of recovery allowed under the three forms of the NFIP's Standard Flood Insurance Policy.[11]

Thus, FEMA recognizes that insurance agents participating in either the NFIP Direct Program or independent agents participating in the NFIP's Write Your Own (WYO) Program are the valuation "experts." ABA suggests that FEMA, as administrator of NFIP, has the power to insist that all agents issuing NFIP flood insurance policies clearly document the insurable value of a property. Thus, the difficult task of ascertaining the insurable value of a property would be appropriately placed on an expert, an NFIP insurance agent, rather than on a lender or a bank compliance officer, and all parties could rely on this value to ensure compliance with the Act.

Section IV: Flood Insurance Requirements for Construction Loans

ABA supports the Agencies' efforts to provide additional guidance to lenders seeking to enforce the mandatory purchase requirement for construction loans. In the past, insured depository institutions and their construction borrowers have had difficulty complying with the requirement that a flood insurance policy insuring a building *to be* constructed be in place at loan origination. Without the completion of a foundation or the issuance of an elevation certificate, many insurance companies refuse to write a flood insurance policy, and those that do often charge a higher premium for the policy. Moreover, the rational basis for this requirement is undermined by the Agencies' admission that "while an NFIP policy may be purchased prior to the start of construction, as a practical matter, coverage under an NFIP policy is not effective until actual construction commences".

In proposed Answer 19, the Agencies recognize these issues and state that as an alternative to having the policy in place at origination, a lender may allow a borrower to defer the purchase of flood insurance until a foundation slab has been poured or an elevation certificate has been issued. In the latter scenario, however, the Agencies will require the lender to have in place a monitoring procedure to ensure that the borrower obtains insurance as soon as the foundation is complete or the elevation certificate is issued and that no further funds are disbursed until the borrower complies. Banks with large construction loan portfolios anticipate that the monitoring process will be a significant burden. Indeed, they anticipate that the time

[11] *Id.* at 29.

and expense of monitoring construction loans may preclude use of this second alternative.

Therefore, ABA urges the Agencies to work with FEMA to consider other options that could provide adequate flood insurance to construction borrowers and lenders. These options could include the creation of an NFIP builder's risk policy or the endorsement of private WYO builder's risk insurance that expressly includes flood insurance coverage. The builder's risk policy would provide more effective coverage to construction borrowers and lenders because it could commence immediately upon delivery of materials to the construction site and continue until the construction phase has been completed and the construction loan is replaced with permanent financing. At this time, the builder's risk policy could automatically convert to a conventional NFIP flood insurance policy.

Alternatively, the Agencies should consider making a limited exception to the rule that gap or blanket insurance policies are not an adequate substitute for NFIP flood insurance. Indeed, in proposed Answer 57, the Agencies recognize that "In limited circumstances, a gap or blanket policy may satisfy a lender's flood insurance obligations, when NFIP and private insurance is otherwise unavailable." Instances when construction borrowers cannot place flood insurance before the completion of foundation work or the issuance of an elevation certificate could be expressly recognized by the Agencies as a circumstance when a gap policy is a legitimate means of satisfying the mandatory purchase requirement.

The following statement by FEMA, which is recited by the Agencies in Answer 18, underscores the need for an alternative means to provide flood insurance for construction loans:

> Buildings in the course of construction that have yet to be walled and roofed are eligible for coverage except when construction has been halted for more than 90 days and/or if the lowest floor used for rating purposes is below the Base Floor Elevation.

In the latter instance, FEMA and the Agencies require that the building be walled and roofed before coverage is available. ABA members believe that to require the purchase of flood insurance at closing, or even at the completion of foundation work, when coverage under the policy will not commence until the building has been walled and roofed is unreasonable. Therefore, ABA urges the Agencies and FEMA to endorse other insurance alternatives, including a builder's risk or a gap policy, which could provide more adequate insurance protection.

Section VI: Flood Insurance Requirements for Residential Condominiums

Section VI of the proposed Questions and Answers addresses the many practical questions that arise from the application of the mandatory purchase requirement to residential condominiums. ABA and its member banks appreciate the Agencies' effort to provide specific examples of how to calculate the necessary flood insurance for residential condominiums. Insuring condominiums from flood loss is complicated by their unique ownership structure; each building has common elements owned by all and individually owned units. Recognizing both of these

ownership interests, the NFIP makes two kinds of flood insurance available to insure condominiums: a Residential Condominium Building Association Policy (RCBAP) and a Dwelling Policy. The RCBAP is a master policy issued to a condominium association; it is designed to insure both common and individually owned building elements from flood loss. A Dwelling Policy can only be issued to an individual unit owner, and it is intended to protect the individual unit owner's interests.

Recognizing that condominium association board members have a fiduciary duty to provide adequate flood insurance to protect a building located in a SFHA, the NFIP program is structured to make a RCBAP issued at full replacement cost value the least expensive and most efficient way to provide the maximum insurance against flood loss for both common and individual building elements. Accordingly, under the NFIP, a Dwelling Policy, issued to an individual unit owner, is only necessary if the condominium association does not obtain a RCBAP at full replacement cost value. It should also be noted that the insurance provided by the Dwelling Policy does not provide the protection that could have been provided by a RCBAP at full replacement cost coverage. A Dwelling Policy only provides the unit owner with supplemental building coverage that responds to shortfalls related to assessments and unit improvements. It cannot extend RCBAP limits or fill gaps in RCBAP coverage, and therefore it is considered to be an inferior way to secure the maximum flood insurance protection available under the Act.

The difficulty applying the mandatory purchase requirement to condominiums arises from two related issues. First, there is uncertainty about how the Agencies define "insurable value" and about how to determine a building's replacement cost value. Second, confusion arises from earlier guidance suggesting that an RCBAP issued at 80% replacement cost value satisfied the mandatory purchase requirement, making it unnecessary for a unit owner to purchase a Dwelling Policy. ABA believes that both of these issues remain unsatisfactorily resolved by the proposed Questions and Answers.

For the reasons previously discussed, ABA urges the Agencies to define "insurable value" clearly and to provide lenders with direction about the documents they can rely on to ascertain and document a building's replacement cost value. The lack of clear and unequivocal definitions of these terms injects the already difficult task of determining the replacement cost of a building with additional uncertainty. Lenders are neither expert property appraisers nor insurers; they should not have to struggle to determine the insurable value of a building in order to ascertain whether RCBAP protection satisfies the statutory maximums. ABA requests that the Agencies acknowledge that lenders lack the necessary expertise to derive replacement cost value from hazard insurance policies or property appraisals. Moreover, ABA notes that on October 1, 2007, it became the NFIP's stated policy to require insurance agents to document the replacement cost value of a condominium on the declarations page of all new or renewed RCBAP policies. ABA urges the Agencies, in the final Questions and Answers, to direct lenders to rely on the value stated on a declarations page of all RCBAP policies issued after October 1, 2007. By this simple act, FEMA will be put on notice that lenders will rely on this information, and presumably FEMA will insist that its agents follow policy and document each condominium's replacement cost value. Thus, going forward, the troubling issue of how to ascertain replacement cost value will cease to be an issue.

The second issue creating confusion for lenders attempting to enforce the mandatory purchase requirement for condominiums is uncertainty over whether an RCBAP issued at 80% replacement cost is sufficient. Previous guidance from the Agencies and FEMA suggested that such a policy satisfied the mandatory purchase requirement. In proposed Answer 24, however, the Agencies answer this question in the negative. They establish the rule that that unless an RCBAP provides "either100% of the insurable value (replacement cost) of the building…or the total number of units in the condominium building times $250,000, whichever is less," a lender must require an individual unit owner to purchase a Dwelling Policy as a condition precedent to the extension of credit.

Because requiring the purchase of RCBAP at 100% replacement cost value is the least expensive and most efficient way to protect the financial interests of all parties from flood loss, ABA supports the Agencies' clarification. ABA's objection to the new guidance, however, arises from language in proposed Answer 24 that suggests that the Agencies will apply this rule retroactively. After announcing the new requirement for 100% replacement cost coverage and clearly stating that it will apply to any loan that is made, increased, extended, or renewed after the effective date of the revised guidance, the Agencies add—

> Further, the guidance will apply to any loan made prior to the effective date of the guidance, which a lender determines to be covered by flood insurance in an amount less than the Regulation, and as set for the in proposed question and answer 24, *at the first flood insurance policy renewal period* following the effective date of the revised guidance. (emphasis added)

In addition, the following language in proposed Answer 27 further extends the backward reach of the new rule. The Agencies state that, "If a lender determines *at any time* during the term of a designated loan that the loan is not covered by flood insurance or is covered by such insurance in an amount less than the mandatory flood insurance requirement" (emphasis added) then the lender must direct the borrower to work with the condominium association to meet the regulatory minimums, and failing this the lender must require the borrower to purchase an individual dwelling unit policy or force place a policy. ABA believes that the practical effect of these two statements will be the retroactive enforcement of the new rule, which is unfair to lenders and borrowers. We request that the Agencies strike both sentences from the proposed Questions and Answers.

Because prior guidance issued by both FEMA and the Agencies suggested to all that 80% RCBAP coverage was adequate, lenders relied on this. In those instances when there was evidence of an RCBAP at 80%, lenders issued mortgages to individual unit owners without requiring the purchase of a Dwelling Policy. If the language in issue is allowed to stand, the effect will be the unfair retroactive application of a new rule that will punish both the lender and its customer. Upon receipt of an RCBAP renewal or following a routine flood insurance compliance review, lenders will be forced to require mortgagors to purchase a Dwelling Policy. Lenders will be justifiably reluctant to inform customers that they must purchase an expensive policy that may not provide adequate coverage in the event of a loss, and mortgagors will resent this eleventh hour change to their mortgage contract. Although the intent

behind the new guidance is worthy – ensuring that condominiums are adequately protected against flood losses— the practical effect of this additional language may be the opposite. Angry borrowers faced with having to purchase a Dwelling Policy (or having it force placed by the lender) may choose to refinance their condominiums with a mortgage company that is not subject to the mandatory purchase requirement.

Moreover, if the unspoken intent of the proposed guidance is to impose on federally regulated lenders responsibility for ensuring that condominium associations purchase an RCBAP with 100% replacement cost coverage, ABA respectfully suggests that this new responsibility is misplaced. Banks have limited power to influence the actions of a condominium association. A bank can only suggest to an individual mortgagor that he/she ask the condominium association to increase its RCBAP. If the association refuses, the bank is powerless to do anything but insist that the individual purchase a Dwelling Policy as a condition to obtaining a mortgage. In contrast, FEMA, acting through the NFIP, has significantly more leverage over a condominium association. The NFIP is the only entity that can issue an RCBAP; its agents can simply refuse to issue or renew an RCBAP for less than 100% replacement cost coverage. The Agencies should not permit FEMA and the NFIP to abdicate their responsibilities in this area and expect insured depository institutions to fill in the breach.

<u>Section VII: Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA</u>

ABA supports the proposed Questions and Answers in this section but requests that the Agencies provide additional guidance, including specific examples, demonstrating how to calculate the required flood insurance when a lender takes a security interest in contents as well as a building.

In addition, in proposed Question and Answer 32, the Agencies require a lender that makes a second mortgage secured by a building located in a SFHA to ensure that adequate flood insurance is in place for the first and second mortgages. The Answer states, "The lender on the second mortgage cannot comply with the Act and Regulations by requiring flood insurance only in the amount of the outstanding principal balance of the second mortgage without regard to the amount of flood insurance coverage on a first mortgage." Although the Answer is silent with respect to force placement, ABA is concerned about its implications in situations in which a second lien holder determines that it must force place insurance. FEMA's 2007 Guidelines provide the only guidance on this force placement issue—

> A secondary lienholder that force places coverage only to the extent of its loan will not protect its interest if a first mortgagee claims priority to any insurance proceeds. Force placement by a second mortgagee will require coordination with the first mortgagee, as well as with the insurance producer and insurer on the first mortgage, if one exists.[12]

[12] *Id.*at 41.

ABA member banks report that requiring a secondary lien holder to coordinate with the first mortgagee would create unnecessary delay and burden as the second mortgagee or its servicer must identify and then contact the first lien holder. Moreover, coordination of force placement efforts by the first and second lien holders is likely only to be achieved through the Mortgage Portfolio Protection Program (MPPP), a program that many banks avoid using because of program inefficiencies. Therefore, ABA urges the Agencies to provide additional guidance in this area, and in particular, to recognize that efficiency dictates that each mortgagee should only be required to force place coverage in an amount equal to its loan balance. Because each lender is similarly obligated by law to force place for its individual loan balance, collateral will be properly secured.

Section VIII: Flood Insurance Requirements for Loan Syndications/Participations

Question and Answer 40 address the flood insurance requirements for loan syndications and participations. The proposed answer begins by acknowledging a practical reality, namely that the many parties to a syndication or participation agreement assign flood compliance responsibilities to the lead lender or agent. However, the answer significantly limits reliance on these agreements by stating that each party to a participation or syndication agreement is individually responsible for ensuring compliance *and* that each participating lender will face examination to determine whether it has adequately discharged this responsibility. The answer describes the nature of this examination in considerable detail, imposing on the participating lender a multi-layered responsibility for "upfront due diligence to ensure both that the lead lender or agent has undertaken the necessary activities to ensure that the borrower obtains appropriate flood insurance *and* that the lead lender or agent has adequate controls in place to monitor on-going compliance." (emphasis added) In addition, the examination will investigate whether the participating lender has "adequate controls to monitor the activities *of the lead lender or agent* to ensure compliance with flood insurance requirements over the term of the loan." (emphasis added)

By this language, the Agencies appear to be imposing a new regulatory burden on participating lenders that is likely to lead to unnecessary duplication of effort and confusion for borrowers. Loan syndications and participations typically bring together a large number of lenders. The only efficient way to handle the multitude of compliance responsibilities, including flood compliance, is for the parties to assign responsibility to a lead agent/lender. Requiring each participating lender to document its due diligence and ongoing efforts to monitor flood compliance will result in a burdensome duplication of effort for all and potential confusion to the borrower or discourage banks to participate in syndications, particularly if their participation is relatively small in comparison with the cost of this new duty. ABA urges the Agencies to remove the language expressly providing for an examination of each participating lender before it results in boxes to be checked off on an examination and defensive and unnecessary action by insured depository institutions.

Section XI: Forced Placement of Flood Insurance

Question and Answer 54 address a bank's responsibility for force placing flood insurance. Tracking the Act and Regulations, the proposed guidance recites the facts which require a bank to force place flood insurance, and it directs the lender to

notify the borrower of the required amount of flood insurance that must be obtained within 45 days of notification. The guidance further directs the bank to notify the borrower that if the borrower fails to obtain the insurance within the 45-day period, the lender will purchase the insurance on behalf of the borrower. This process and the 45-day period are clearly established by the Act and Regulations. However, neither address the date by which a bank must have force placed flood insurance following the conclusion of this 45-day period. Nevertheless, some ABA member banks report that they have been subject to regulatory criticism for the failure to have force placed insurance on day 46.

ABA believes that to expect a bank to force place flood insurance the day after the expiration of the statutory time period is an unreasonable interpretation of the regulatory language. It assumes that a borrower intentionally failed to comply with the mandatory purchase requirement, an assumption that cannot be automatically assumed to be valid. Moreover, it imposes an undue burden on banks. Force placing flood insurance is not a simple matter, and in those instances when a borrower does comply with the notice, the time and effort spent preparing to force place on day 46 will have been wasted. Accordingly, ABA urges the Agencies to use this opportunity to provide additional guidance. In particular, ABA suggests the articulation of a flexible standard, requiring a bank to force place flood insurance "as soon as practical" following the conclusion of the 45-day notice period. ABA believes that the adoption of such a flexible standard is a reasonable and workable interpretation of the regulatory framework that will promote the consistent interpretation and application of the mandatory purchase requirement.

Section XV: Flood Zone Discrepancies

The proposed guidance in Section XV represents the culminating step in a general trend to place full responsibility for resolving zone discrepancies on insured lenders. In Answer 65, the Agencies announce that a lender can be found in violation of the federal flood insurance regulations if—despite the lender's diligence in making the flood hazard determination, notifying the borrower of the risk of flood and the necessity for flood insurance, and requiring the purchase of flood insurance—there is a discrepancy between the flood hazard zone designation on the notice and the flood insurance policy. However, even as they make this announcement, the Agencies fail to define clearly what a "zone discrepancy" is, and they do not point to a particular regulation that will be cited as the basis for the violation.

First, the Agencies need to define clearly what will constitute a zone discrepancy. Since its inception, the NFIP has worked to fulfill one half of its dual mandate by creating detailed maps of the flood hazards in participating communities. These Flood Insurance Rate Maps (FIRMs) delineate special flood hazard areas (SFHAs) and the applicable flood insurance risk zones. SFHAs are represented on FIRMs by darkly shaded areas designated with the letter A or V. Over the years, the maps have changed; older FIRMs show numbered A zones (e.g., A1, A2, A30) and numbered V zones (e.g., V1, V2, V30), but newer FIRMs use zone AE to represent former zones A1 through A30 and zone VE to represent former zones V1 through V30. Thus, the question arises: if a flood hazard determination identified the zone as A1, but a flood insurance policy renewal is written for a zone AE, is this a zone discrepancy? If a flood hazard determination identified the zone as AE, but a flood insurance policy is written for a zone AO, is this a zone discrepancy?

In addition, newer maps often identify larger areas of high flood hazard than older maps. Because FEMA recognizes that property owners might not have proceeded to build in high flood risk areas if the risks had been identified previously, FEMA has created grandfather rules to avoid penalizing these policy holders. Under the grandfather rules, if a property owner built in compliance with an earlier FIRM and has continuously maintained federal flood insurance, despite a map change that should call for the payment of a higher flood insurance premium, an insurance policy may be rated using a prior FIRM and Base Flood Elevation (BFE). As a result, a flood hazard determination based on the most recent FIRM may identify a property as located in a higher risk flood zone, but because of grandfather rules the policy may be legitimately written for a different zone. However, apart from engaging in extensive research of historic flood maps and BFEs, there is currently no way for a lender to determine with confidence whether a policy was legitimately grandfathered.

In answer 65, the Agencies decree that "if more than occasional, isolated instances of unresolved discrepancies are found in a lender's loan portfolio, the agencies may cite the lender for a violation of the mandatory purchase requirements." However, they fail to define which of the many possibilities for discrepancy would constitute a true zone discrepancy subjecting the lender to censure. Nothing in the Act or the Regulations imposes this duty on a lender. The Act and Regulations simply require the lender to make the flood hazard determination; to notify the borrower of the risk of flood and the need to obtain flood insurance; and to require the purchase and maintenance of flood insurance. Nevertheless, the Agencies are reaching beyond the express terms of the Act and Regulations as they announce that the failure to resolve more than "occasional, isolated" zone discrepancies will be cited as a compensable violation of the mandatory purchase requirement.

In addition, the past practice of the regulatory agencies charged with administration of the flood insurance laws contradicts such a finding. Indeed, the standard NFIP flood insurance policy includes reformation provisions pursuant to which a flood policy written for an incorrect zone may be reformed at the time of a loss. Pursuant to these provisions, FEMA essentially rewrites the policy to provide to the insured the maximum amount of coverage available and deducts from the insurance payment the amount of the premium that should have been paid had the policy been written for the correct zone. In essence, the finding that a policy was issued for an incorrect zone is not deemed to be a failure of insurance; instead, it simply raises a rating or pricing issue that can be resolved satisfactorily at the time of a claim. As long as the mandatory regulatory coverage requirements are met in the policy tendered by the borrower, the bank has fulfilled its compliance obligations, and any deficiency is a rating or pricing issue that FEMA has the authority to resolve with agents or, in the event of loss, with the borrower. Until FEMA published the 2007 Guidelines and the FDIC published Financial Institution Letter 114-2007, the Agencies viewed zone

discrepancies in this light, and banks were not expected to identify or to resolve them.[13]

To place responsibility for resolving zone discrepancies on insured depository lenders is to burden them with yet another duty which they lack the expertise and authority to resolve. The NFIP flood insurance agent -- whether it is an NFIP agent issuing an NFIP Policy or a WYO agent issuing a policy -- has the responsibility to the insured and to NFIP to issue a policy rated for the appropriate flood zone noted on the flood determination. Lenders should not have to undertake the highly technical and time consuming investigation and reconciliation of a zone discrepancy. It is the insurance agent who issued a policy for a different zone than that noted on the flood hazard determination that should be held responsible by FEMA for reconciling discrepancies, not the lender by its federal regulator.

Perhaps in recognition of the difficult nature of these resolutions, in the Questions and Answers the Agencies direct a lender unable to resolve a zone discrepancy to join with the borrower to request a zone determination by FEMA. These requests must be submitted within 45 days of the lender's notification to the borrower of the requirement to obtain flood insurance. Unfortunately, in practice this review process may not be available to help banks. ABA member banks report that in order to satisfy the mandatory purchase requirement, they usually accept a copy of the flood insurance application and evidence of payment at closing. A copy of the actual flood insurance policy may not arrive at the lender's office for several weeks. If a comparison of the zone identified on the policy with that on the flood hazard determination form reveals a discrepancy, efforts to resolve the discrepancy may take several weeks, because neither the borrower nor the insurance agent is particularly interested in the issue after loan closing. As a result, the lender is likely to determine that a request for a Letter of Determination Review (LODR) by FEMA is necessary long after the 45 day time period has run.

This leaves the lender with an unattractive alternative in order to be in compliance with the proposed guidance—force place insurance while the zone discrepancy is sorted out or suffer the risk of being cited for lack of compliance. However, lenders will be justifiably reluctant to do this. The effect of force placing a policy may be to drive a frustrated borrower to cancel the less expensive and more comprehensive NFIP insurance (force placed flood policies generally provide only building coverage, while many NFIP policies cover contents as well as the building). The net effect may be the opposite of that intended by the proposed guidance; while in technical compliance with the flood rules, the borrower and the bank may be less adequately insured against flood loss.

ABA believes that the proposed requirement for banks to resolve zone discrepancies imposes an unnecessary burden not mandated by law. Moreover, there is no

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[13] Moreover, Congress' awareness of the fact that zone discrepancies occur and of the NFIP reformation provisions is demonstrated by its passage of section 209 of the Flood Insurance Reform Act of 2004. Section 209(f) provides: "ADJUSTMENT OF PREMIUM – Notwithstanding any other provision of law, if the Director determines that the holder of a flood insurance policy under this Act is paying a lower premium than is required under this section due to an error in the flood plain determination, the Director may only prospectively charge the higher premium rate." 42 U.S.C. §4015(f).

compelling reason to impose this burden. The NFIP's existing practice of reforming zone discrepancies at the time of loss is the most efficient and least expensive way to address discrepancies.

Need for Guidance on Private Insurance and Multi-Peril Policies

In response to the Agencies invitation to request guidance on issues not presented by the Questions and Answers, ABA requests that the Agencies provide guidance on the private insurance and multiple peril policies. Although private insurance is an accepted alternative to a NFIP policy, FEMA's guidance on assessing the adequacy of private policies is limited and has engendered significant uncertainty among lenders trying to determine whether a policy meets the regulatory minimums. In the 2007 Guidelines, FEMA states only—

> A private flood insurance policy that meets all six of the FEMA criteria described in **a.** through **f.** below conforms to the mandatory flood insurance purchase requirements of the 1994 Reform Act. To the extent that the private policy differs from the NFIP Standard Flood Insurance Policy (SFIP)…the differences should be carefully examined before the policy is accepted as sufficient protection under the law.[14]

The criteria described in paragraphs a through f, however, provide limited guidance to banks seeking to assess the adequacy of a private flood insurance policy. Indeed, paragraph d., titled "Breadth of Policy Coverage," is merely a re-statement of the above; it states, "The policy must guarantee that the flood insurance coverage, considering deductibles, exclusions, and conditions offered by the insurer, is at least as broad as the coverage under the SFIP."[15]

ABA member banks report considerable difficulty assessing the adequacy of private policies. Their compliance officers and loan administration personnel are not insurance experts, yet they are being asked to make difficult technical evaluations of private policies. In particular, banks are uncertain about whether a multiple peril policy can satisfy the regulatory minimums, and efforts to have FEMA provide definitive guidance have been unsuccessful.

Banks fear that their decisions as to the adequacy of a policy could subject them to regulatory criticism or other risks if a private policy accepted as sufficient was later determined to be inadequate. This uncertainty is compounded by the fact that within the last year banks report being presented with an increasing number of private policies and multiple peril policies. ABA urges the Agencies to provide clear direction as to the acceptability of multiple peril policies and additional guidance that lenders can use to assess the adequacy of private policies. Without such guidance, ABA contends that the participation of private insurers in the NIFP will be limited, thereby restricting an important flood insurance alternative for borrowers and lenders.

[14] *Id.*at 58.
[15] *Id.*

Conclusion

ABA appreciates the opportunity to comment on the Interagency Questions and Answers Regarding Flood Insurance. This guidance can provide much needed clarity and direction to banks as they seek to comply with the mandatory purchase of flood insurance regulations. However, for the reasons discussed above, ABA urges the Agencies to use restraint and to guard against using the Questions and Answers to extend a bank's compliance obligations beyond that intended by Congress.

If you have any questions about these comments, please contact the undersigned at (202) 663-5073 or via e-mail at voneill@aba.com.

Sincerely,

Virginia O'Neill
Senior Counsel
Center for Regulatory Policy