From: "Randy Carey" <careyrandy@comcast.net> on 05/20/2008 09:25:05 PM

Subject: Flood Insurance Q&A

May 20, 2008

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551.

Re: Docket No. OP–1311
Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance

Dear Ms. Johnson:

I appreciate the opportunity to comment on the proposed Interagency Questions and Answers Regarding Flood Insurance. I am a regulatory compliance consultant that provides compliance consulting and auditing services to a number of banks which are regulated by all of the major Federal financial institution regulatory agencies.

I support the actions through the Interagency cooperative effort to provide additional guidance to financial institutions to support their efforts to comply with the flood insurance regulations and the recent guidance document from the Federal Emergency Management Agency (FEMA) entitled the *Mandatory Purchase of Flood Insurance Guidelines* (MPFIG) published in September 2007. Following are my comments on the specific proposed Questions and Answers in which further clarification by the regulatory agencies would be appreciated based on my experience with assisting financial institutions to maintain compliance in this area.

Regarding the questions #7 and #10, the Questions and Answers proposal introduces the term called "insurable value" in question #7. While the regulators have introduced this term, they have done little to define the meaning of "insurable value". It states that "It is very important to calculate the correct insurable value of the property," without any additional explanation outside of the fact that the land value is not included in the calculation.

Additionally, the answer to question #10 states:

The amount of insurance required by the Act and Regulation is the lesser of:

- The outstanding principal balance of the loan(s) or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
  - The maximum limit available for the type of structure or
  - The ''insurable value'' of the structure (see Question 7).

This may or may not be in direct conflict with the guidance found in the MPFIG, page 27, Calculating Coverage which states:

To meet compliance requirements, the amount of flood insurance must at least be, but is not

- The outstanding principal balance of the loan(s); or
- The maximum amount of coverage available under the NFIP for the particular type of building; or
- The full insurable value of the building and/or its contents, which is the same as 100-percent replacement cost value (RCV). (Unlike the practice in other lines of property insurance, building RCVs under the NFIP do not include market values or the value of the land.)

Therefore, the MPFIG defines insurable value as 100-percent of replacement cost value and the Questions and Answers proposal does not address replacement cost value in relationship to the term insurable value.

The definition of insurable value in the MPFIG presents a serious issue for financial institutions and makes little sense from a practical application in some circumstances. While residential structures used as primary residences can be insured and insurance benefits will be paid up to the lesser of the insurance policy limit or the replacement cost, this is not true for properties that are required to be insured under a General Policy Form policy.

For example, on a $500,000 loan secured by a non-residential building located in a Special Flood Hazard Area, the customer that has a non-residential building can only purchase flood insurance under a General Property Form policy. If the building has Replacement Cost Value (RCV) of $500,000, but only an Actual Cost Value (ACV) of $150,000 due to depreciation, under the guidance in the MPFIG you have to make the borrower purchase $500,000 in insurance. It would be very helpful for the regulators to address the inconsistencies that now exist in the new MPFIG between how the full insurable value is defined and the amount that a borrower could possibly collect under a General Policy Form. Financial institutions are going to face an untenable situation as insurance agents are going to be reticent to insure buildings for RCV when only the ACV is going to be paid in the case of a loss suffered by the customer.

The MPFIG additionally suggested that 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. The proposed Questions and Answers in the answer to Question #7 additionally states that: “It is very important to calculate the correct insurable value of the property; otherwise, the lender might inadvertently require the borrower to purchase too much or too little flood insurance coverage. For example, if the lender fails to exclude the value of the land when determining the insurable value of the improved real property, the borrower will be asked to purchase coverage that exceeds the amount the NFIP will pay in the event of a loss.” This would appear to indicate that the amount that the NFIP will pay in the event of a loss is a valid consideration in the mandatory purchase requirements.

I am aware of several financial institutions having sought guidance from their regulatory examiners on this issue and the examiners have instructed the institutions that according to the new MPFIG the insurable value is now always considered to be the replacement cost value of the building, regardless of the circumstances.

I fully believe that this statement: “The full insurable value of the building and/or its contents, which is the same as 100-percent replacement cost value (RCV)…” in the MPFIG not totally correct as it does not take into consideration all circumstances. While it may be true for a Dwelling Form policy, it makes no sense for a property covered under a General Property Form

policy.

It is going to be imperative that the regulators fully explain the differences between RCV and ACV and the correct methods to calculate the required amount of insurance when RCV is beyond the insurable value of a building.

Regarding question #35, "Is flood insurance required if a building and its contents both secure a loan, and the building is located in an SFHA in which flood insurance is available? Answer: Yes. Flood insurance is required for the building located in the SFHA and any contents stored in that building."

Clear guidance has not been issued from a regulatory body regarding how the minimum flood insurance requirements should be applied when both the building and the contents are taken as security and located in a SFHA. It would be very helpful if the regulatory agencies could provide solid examples of coverage calculations, as they have when a condominium is involved in the transaction. For example, if a lender has a loan for $200,000 secured by a non-residential building with an insurable value of $150,000 and contents with an insurable value of $100,000; what is the proper method to determine the minimum flood insurance requirement? Would it be any combination of insurance on the building and contents to equal the loan amount of $200,000 or would the insurance requirement be applied based on the value of the building and contents separately, irrespective of total coverage, i.e., $150,000 flood insurance for the building and $100,000 for the contents, since that is the lesser amount of insurance available, the loan amount, or the value of the building/contents applied separately.

Yours very truly,

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