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By electronic delivery

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Regulation Comments,
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1700 G Street, NW.
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Attention: No. 2006–19
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Jennifer J. Johnson, Secretary
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Gary K. Van Meter, Deputy Director
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Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
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Mary F. Rupp,
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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:

Citibank, N.A., on behalf of itself and its subsidiaries, appreciates the opportunity to submit this comment in connection with the proposed Interagency Questions and Answers ("the Proposed Q&A") regarding Loans in Areas Having Special Flood Hazards, issued jointly by the Office of 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")[1].

[1] 73 Fed. Reg. 15259 (March 21, 2008)

Background: Flood Insurance and Flood Protection Requirements Pursuant to Federal Statutes.

We acknowledge the importance of flood insurance to us and our borrowers and appreciate the Agencies' attempt to clarify the rules relating to our responsibilities under Federal flood insurance legislation.

In doing so we would like to remind the Agencies that the role of a financial institution is limited by that legislation. Under the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as revised by the National Flood Insurance Reform Act of 1994 (together, the "Acts")[2], the responsibilities of financial institutions are straightforward:

First, a financial institution is directed not to "make, increase, extend, or renew" any loan secured by improved real estate or a mobile home in an area that has been designated by the director of the Federal Emergency Management Agency ("FEMA") as a special flood insurance area ("SFHA") unless the building or mobile home and any personal property securing the loan is covered by the required amount of flood insurance.

Second, if a financial institution requires the escrowing of taxes, insurance premiums, or certain other fees and charges in connection with the secured loan, then it must also escrow for flood insurance premiums.

Third, a financial institution must force place insurance if, at any time during the term of the secured loan, it determines that the security property is not covered by flood insurance or is covered by insufficient flood insurance.

Fourth, a financial institution is required to provide a notification of special flood hazards to the borrower and to the servicer of the loan.

Fifth, in connection with the making, increasing, extending, renewing, selling or transferring of any such loan, the financial institution must notify the director of FEMA of the servicer of the loan, or of any change in the servicer of the loan.

In addition, the Acts also created the National Flood Insurance Program ("NFIP"), which is administered by the FEMA. FEMA is responsible for identification of special flood hazard areas ("SFHA")[3] and management of a federal flood insurance program to protect property owners from the risk of flooding. Insurance coverage under the NFIP is provided through insurance agents participating in the NFIP "Direct Program" or independent agents participating in the NFIP's "Write Your Own" program.

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[2] 42 U.S.C. §4001 et seq.

[3] An SFHA is an area that has at least a 1% chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year.

General Concerns. The Proposed Q&A goes beyond the Acts' requirements in multiple respects. It requires that lenders undertake technical, time-consuming and onerous tasks which should more appropriately be delegated to FEMA and its participating insurance agents. These technical duties include the resolution of flood zone discrepancies, determination of the "insurable value" of buildings covered by flood insurance, and, in some cases, the continuous monitoring of a property's flood insurance coverage. In some cases, failure to meet these incremental obligations could subject lenders to civil money penalties. [4]

We believe this increased responsibility is misplaced. It has no foundation in the Acts and is contrary to the initial scheme contemplated by Congress – to establish FEMA as the administrator of the NFIP and the source for resolution of technical determinations. Accordingly, we request that the Agencies refrain from placing lenders in the role of NFIP administrators and keep the primary responsibility with FEMA, where it was originally assigned by Congress.

Determining the Appropriate Amount of Flood Insurance Required Under the Act and Regulations.

In accordance with the Acts, the existing flood insurance regulations[5] (the "Regulations") require the lender, upon the occurrence of any of the triggering events set forth in the Acts, to cause the borrower to obtain flood insurance covering the subject property. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage available for the particular type of property in question. In making this determination, a lender needs to obtain the "insurable value" of the property (the "Insurable Value") since a flood insurance policy cannot exceed that amount.

Proposed Question 7 provides that the "insurable value" is the value of the improvements on the property, including the foundation and any supporting structures, less the value of the land. It is very difficult for a lender to determine the "insurable value" of property, since this requires the lender to discern the value of the land and the value of the supporting structures. These values are typically not found on any of the lender's processing documents. An appraisal, for example, refers to the market value of the property as a whole, including both land and buildings, and a hazard insurance policy refers to the cost or replacement value of the property, again as a whole.

Consequently, the lender's best source for the "insurable value" is the flood insurance agent who provides the flood insurance policy. We ask that the Proposed Q&A expressly indicate that lenders are not required to independently

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[4] 42 U.S.C §4012a(f)

[5] 61 Fed. Reg. 45684 (August 29, 1996). Individual agency rules are codified at 23 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).

determine the “insurable value” of property subject to flood insurance requirements but should use the “insurable value” provided by the insurance agent when determining the amount of flood insurance required. Indeed, FEMA recognizes that the insurance agents are in the best position to determine “insurable value”, and has indicated that the lender “should seek assistance of property insurance agents or companies when determining the appropriate flood insurance coverage amounts, as they do for other lines of insurance”.[6] Placing the responsibility with insurance agents participating in the NFIP would be consistent with the intent of the Acts, which charge FEMA with plenary responsibility for administering the NFIP[7], rather than shifting this responsibility to lenders, who are not in the best position to make these determinations.

Placing responsibility for a task on the technical specialist charged with that task is also important for another reason - to protect lenders who may in good faith incorrectly assess the “insurable value” of a building against causes of action by borrowers who relied to their detriment on these assessments.

Flood Insurance Requirements for Residential Condominiums

Insurance coverage for a condominium must take into account the common elements owned by all unit owners, as well as individually-owned units. To reflect this structure the NFIP makes available a Residential Condominium Building Association Policy (“RCBAP”) and a Dwelling Policy. The RCBAP covers the common and individually owned building elements within the units, improvements within the units, and contents owned in common. The Dwelling Policy covers the individual owner’s unit but cannot extend the RCBAP‘s limits or fill in gaps in the RCBAP’s coverage.

When a lender makes a loan secured by an individual condominium unit, the proposal would require that lender to examine the RCBAP coverage for the condominium building and determine whether that coverage is sufficient.[8] If the lender determines that the RCBAP is insufficient, it must require the borrower to obtain a Dwelling Policy, despite the fact that this policy would not provide the borrower with complete insurance coverage due to its significant limitations.

This puts the lender in the unenviable position of having to require its borrower to pay for additional flood coverage that does not provide the borrower with complete protection. Alternatively, the lender could expend its time and efforts attempting to persuade the condominium association to increase the RCBAP

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[6] Federal Emergency Management Agency, *Mandatory Purchase of Flood Insurance Guidelines* 29 (2007)
[7]42 U.S.C. § 4011(a)
[8] We understand that RCBAP policies issued after October 1, 2007 are required to state the “insurable value” of the building, so at least the lender is spared from having to make that difficult determination in these instances, provided it is permitted to rely on this number when determining the required insurance for a unit owner.

coverage, but since it has no authority over the association it cannot control the association's ultimate decision.

We do not believe the lender should be placed into the middle of flood insurance negotiations in this manner. We believe that FEMA should mandate that its insurance agents issue RCBAP coverage for 100% of the "insurable value" of a condominium building, and request the Agencies to state that lenders may rely on this when lending to individual unit owners. It is unfair to place lenders in the middle of controversies between their borrowers and condominium associations or require them to foist unwanted, incomplete coverage on their borrowers.

We also object to language in Proposed Questions 24 and 25 since it would impose obligations on the lender *with respect to existing loans in its portfolio.* This would extend far beyond the statutory requirement placed upon lenders, which applies only when a lender is making, increasing, extending or renewing a loan[9].

Proposed Question 24 was included to clarify that, contrary to earlier guidance, an RCBAP issued at 80% replacement cost is insufficient. In establishing a rule that RCBAPs require 100% coverage, the response to that question places responsibility *on the lender* to apply the rule retroactively:

> "The guidance...will apply to any loan that is made, increased, extended, or renewed after the effective date of the revised guidance. *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 [insufficient] flood insurance... at the first flood insurance policy renewal period following the effective date of the revised guidance."*

Similarly, proposed Question 53 discusses a situation where the condominium association escrows for flood insurance. In that case, the proposal would require lender to "*exercise due diligence with respect to continuing compliance with the insurance requirements on the part of the condominium association."* Since RCBAP insurance is almost always collected with the unit owner's monthly common charges, this would apply to the majority of condominium loans in a lender's portfolio.

As stated above, we object to the language in both of these Proposed Q&As since it extends a lender's obligations beyond the statute, placing it in a role of "insurance guardian" for condominium associations and other unit owners with whom it has no privity of contract. We believe this would be an unfair rule that has no basis in the Acts. The Agencies themselves acknowledge in the response to proposed Question 6 that a lender is not required to perform periodic reviews

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[9] 42 U.S.C. § 4012a(b)(1)

of their loan portfolios, although lenders may wish to do so for safety and soundness purposes. This rule should be no different for condominium loans.

Flood Insurance Requirements for Construction Loans

Proposed Question 19 outlines the required process for the purchase of flood insurance for a loan secured by property that is in the course of construction. It provides that a lender can require a borrower to have a flood insurance policy in place at the time of loan origination, although we are not aware of any insurance agent who is willing to issue such a policy.

Perhaps the Agencies realize that this process is unrealistic since they have provided an alternative - a lender can allow a borrower to defer the purchase of insurance until a foundation slab has been poured and/or an elevation certificate has been provided, although the lender must monitor construction to make sure that the insurance is in place no later than this. It does not specify *how* the lender is supposed to determine the "insurable value" of improvements before a roof and walls have been constructed. Consequently, the lender must provide its best guess, knowing, on one hand, that it should not cause the borrower to overinsure, but on the other hand, that it could be held responsible by the borrower if insurance proves to be insufficient.

Similar issues arise in connection with construction loans for residential condominium buildings. At the point when a condominium plan is accepted and units begin to be sold, it is unclear whether the building should be treated as a single residential building, subject to the $250,000 limit on insurance, or as multiple condominium residences, subject to the $250,000 per unit limit. (The construction lender has its lien only on the unsold units.)

These are situations where FEMA and its associated insurance agents should provide guidance. We request the Agencies to work with FEMA to provide practical, workable rules for construction loans, or at the very least to state that lenders who rely on insurance agents to provide appropriate coverage during construction may not be held accountable if that coverage is determined to be insufficient.

Flood Insurance Requirements for Subordinate Liens

Proposed Question 32 requires a lender, when it makes a second mortgage, to "ensure" that adequate flood insurance is in place or require that additional coverage be added in the amount of the lesser of either the combined total outstanding principal balance of the first and second loan, the maximum amount available under the Acts, or the insurable value of the building or mobile home. It expressly states that "[T]he lender on the second mortgage cannot comply with the Acts 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 the first mortgage."

We agree that it is appropriate, at the origination of the junior lien, to take the first mortgage into account when determining the appropriate amount of flood insurance. Indeed, since typically only one insurance policy is issued for the property as a whole, we would have to make sure that the first lien is covered by that policy since the first lienor would be paid in full before any payments are made to the second lienor.

We are concerned, however, about the implications that this rule would have if we, as a junior lender, had to force-place insurance.

When a second lienor force-places insurance, it generally purchases a standalone private flood insurance policy[10] that covers only the amount of the second lien. At this point, the loan is typically in the hands of a servicer who is not aware of the existence of prior liens or whether those prior lienors force-placed their own insurance. Requiring the servicer to search for the existence of prior liens would entail delay and incremental cost, over and above the cost of private flood insurance. If the servicer discovered prior liens, it would most likely have no choice but to overinsure the borrower, since the first lienor would typically be reluctant to release information to the servicer about its relationship with the borrower due to privacy concerns[11].

For the reasons above, we ask that the Agencies to clarify that their "formula" for required insurance in Proposed Question 32 would not require a junior lienor to take any senior liens into account when force-placing insurance.

Flood Insurance Requirements for Loan Syndications/Participations

It is well-established industry practice for lenders that are members of a syndicate to rely on the administrative agent for the facility to handle flood insurance matters, which the lead-in to the Agencies' proposed response to Question 40 appears to recognize. It is important to note that although administrative agents are not contractually bound to assume such flood insurance responsibilities or to indemnify syndicate members, they nonetheless take care of flood insurance both as a matter of market practice and because such agents are almost always themselves regulated lenders.

However, the Agencies' response to Proposed Question 40 goes on to state that "the Agencies will examine whether the regulated institution/participating lender

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[10] Privately placed insurance is sold by private insurance companies rather than through the FEMA programs.

[11] We note the Agencies' position with respect to over-insurance, as reflected in Proposed Question 13, which states that lenders should avoid creating situations where a building is overinsured.

has performed 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 to monitor the loan(s) on an on-going basis for compliance with the flood insurance requirements. Further, the Agencies expect the participating lender to have 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."

Requiring a syndicate member to perform such due diligence on an administrative agent and to monitor the agent's internal flood insurance and loan monitoring controls is neither practical nor realistic. We believe that administrative agents are highly likely to resist a rule that would allow other institutions to perform due diligence, or have any ongoing monitoring rights over, the agents' internal, proprietary loan monitoring systems. Nor are they likely to agree to provide copies of their internal policies and procedures to third parties. The problem would be compounded with duplicative requests from every lender in the syndicate, which, in large facilities, can number in the dozens.

These requirements would also force participating lenders to devote significant personnel and resources to conduct ongoing oversight of the administrative agent for each loan, which could be extremely onerous if the lender has an active loan participation program. We are concerned that the practical effect of the proposal would be to lock-out regulated lenders as participants in the loan syndication market if, as we suspect, administrative agents would not permit these intrusions into their organizations.

In addition, the Agencies' position that syndicate members perform due diligence with respect to flood insurance matters and monitoring of the administrative agent is at odds with its position that lenders that come into the facility during secondary syndication have no such responsibilities. Therefore, by delaying entering into the facility until a day or two after closing, a lender would be relieved of these burdens. It would be reasonable to take a consistent approach for both primary and secondary syndications, and permit lenders that enter a facility in the primary syndication to rely on the administrative agent for flood insurance matters, just as the Agencies permit such reliance by lenders in the secondary syndication market.

Our risk function evaluates the reputation, course of dealing and available information concerning the administrative agents with whom we transact. Any further due diligence by a lender would be unrealistic and contrary to accepted industry practice.

<u>Forced Placement of Flood Insurance.</u>

We request a minor clarification to Proposed Question 54 relating to the lender's process of force placing flood insurance. This question states that the lender must force place insurance if the borrower has not done so within 45 days after notification by the lender. This can be read to require the lender's flood insurance to be *in place* by the 46th day. This does not allow for the normal processing time. Consequently, we ask that the Agencies clarify that the insurance need not be in place on the 46th day, but as soon as practicable thereafter. Alternatively, we ask that the Agencies expressly stipulate that the procurement of an insurance binder (as opposed to the policy itself) on Day 46 is acceptable under the regulations.

Abundance of Caution Mortgages

Proposed Question 37 would require a lender to obtain flood insurance in a situation where it is taking a security interest in property only as an "abundance of caution." We request the Agencies to reconsider this issue.

When we take a mortgage as an abundance of caution, the real estate is only an incidental part of the repayment expectation. Underwriting practices for the underlying loan in these cases are very different from loans where the mortgage is considered as primary collateral for a loan, since they focus very little, if at all, on the value of the property. For this reason, we typically would not conduct an appraisal of the property and would only have a general sense of its value. Requiring the lender to obtain flood insurance causes lenders to build an entirely separate process of valuation that is not otherwise necessary. The delay and additional expense this entails creates unhappy borrowers and causes regulated institutions to be less competitive than their unregulated competitors.

Gap Insurance Policies

Proposed Question 57 asks whether or not a lender may rely on a "gap" or "blanket" insurance policy to meet its flood insurance obligations. With very limited exceptions, the Agencies say that a lender may not rely on these types of insurance, reasoning that gap or blanket coverage typically protects only the lender's, not the borrower's, interest, and cannot be transferred when a loan is sold.

We believe that the Agencies should recognize the distinction between "gap" and "blanket" insurance coverage. "Gap" insurance, also known within the industry as "deficiency coverage", is typically purchased by lenders when a borrower has flood insurance, but that insurance is insufficient to meet regulatory requirements. Instead of force-placing a private insurance policy for the entire amount of insurance required, the lender can purchase a gap policy to save the borrower from duplicating coverage and paying unnecessary premiums. Typically, flood gap insurance is written on a particular property and is not written as blanket coverage. Furthermore, in many cases, gap policies provide dual interest (both borrower and lender) coverage.

We urge the Agencies to make a distinction between "gap" and "blanket" flood insurance and continue to permit lenders to purchase "gap" insurance. Failure to do so would negatively impact underinsured borrowers by requiring them to pay duplicate insurance premiums.

Flood Zone Discrepancies

Lenders typically engage third party service providers to complete a flood hazard determination form that specifies the flood hazard zone where a building is located, based on the latest FEMA information. The flood hazard insurance policy also designates the flood hazard zone for purposes of rating the degree of flood hazard risk, which is taken into account in determining the borrower's flood insurance premium. Occasionally, these documents will contain discrepancies in the flood hazard zone which must be appropriately reconciled.

These discrepancies are sometimes caused by the NFIP's "Grandfather Rule" which provides for the continued use of a rating on an insured property when the initial flood insurance policy was issued prior to changes in the hazard rating to the particular flood zone where the property is located. Other discrepancies could arise due to flood map changes and inconsistent use of zone designations over time.

Proposed Question 65 would make *the lender* responsible for resolving these discrepancies. This question states that a lender can be found in violation of the federal flood requirements if, *despite the fact that the lender exercised due diligence in making a flood hazard determination and requiring flood insurance, and notifying the borrower of the risk and the need to obtain flood insurance,* there turns out to be a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy.

We believe that it is entirely inappropriate to shift responsibility to lenders for a task for which the insurance agents and FEMA should be responsible. This is especially true since the lender could be subject to mandatory civil penalties for a failure to reconcile these discrepancies[12]. Not only are discrepancies difficult to reconcile, but lenders and their service providers would need to undertake considerable enhancements to their origination and tracking systems to meet their obligations under this provision. We find no basis in the Acts or Regulations that would require the lender to shoulder this highly technical and time consuming task or to spearhead a petition for a FEMA resolution. The insurance agent, not the lender, is in the best place to make an efficient determination of any zone discrepancies and should be held responsible for them.

[12] 42 U.S.C. a (f)

<u>Compliance Policies and Procedures Should Be Reasonably Designed to Reflect Business Needs and Risk</u>

Our final comment relates not to the flood insurance requirements imposed by the Act, but rather to the policies and procedures that a lender must have in place to implement these requirements. The Agencies have consistently stated that each lender has the responsibility to tailor its own flood insurance policies and procedures to suit its business needs and protect its ongoing interest in the collateral. We agree with this principle, as it recognizes that a “one-size fits all” approach to compliance with the Act and Regulations is neither required nor contemplated by the Agencies.

We request that the Agencies confirm their view that the policies and procedures developed by a lender to ensure its compliance with the Act and Regulations may take into account the unique features of such lender’s business, balanced against the risk of violation (or lack thereof) posed by the business.

For example, consider a business which engages in lending to large corporate customers where real estate is taken as part of a larger collateral pool but is not taken into account when making the credit decision or is only an ancillary component of that decision. That business should have a much different compliance framework with respect to the Act and Regulations than the lender’s consumer-based mortgage business where the real estate collateral is a critical element in the credit decision.

We appreciate the opportunity to comment and hope our comments are useful. If you have any questions relating to these comments or would like to discuss them in further detail, please call me at (212) 559-2938 or Joyce ElKhateeb of my office at (212) 559-9342.

Very truly yours,

Carl Howard

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