68 FR 23425, 05/02/2003

Handbook Mailing HM-03-10

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC20

Eligibility and Scope of Financing

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Farm Credit Administration (FCA) is considering whether to revise its regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who borrow from Farm Credit System (FCS or System) institutions that operate under titles I or II of the Farm Credit Act of 1971, as amended (Act). We are also considering whether we should modify our regulatory definition of "moderately priced" rural housing. We invite your comments.

DATES: You may send us comments by July 31, 2003.

ADDRESSES: You may send comments by electronic mail to "reg-comm@fca.gov," through the Pending Regulations section of FCA's Web site, "www.fca.gov," or through the government-wide "www.regulations.gov" portal. You may also send comments to Robert E. Donnelly, Acting Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by facsimile to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Mark L. Johansen, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Richard Katz, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. <u>Introduction</u>

We received two petitions under 5 U.S.C. 553(e) to repeal § 613.3005, which limits the amount of credit that FCS institutions that operate under titles I or II of the Act can extend to eligible farmers, ranchers, and aquatic producers or harvesters (collectively referred to as "farmers"). The petitioners state that the Act does not restrict the System's authority to finance all the credit needs of any group of eligible farmers and, therefore, § 613.3005 should be eliminated as having no basis in law. The petitioners also state that § 613.3005 unnecessarily restricts the System's ability to serve creditworthy and eligible farmers, particularly those who have significant off-farm income, and young, beginning, and small farmers. One petitioner also asked us to change the definition of "moderately priced" rural housing in § 613.3030(a)(4). The petitioner stated that this definition has not kept pace with the evolving rural housing market and, therefore, is preventing FCS institutions that operate under titles I and II from fully serving the housing needs of eligible non-farm rural residents.

We have decided to start a rulemaking in response to these two petitions. We reserve judgment on the appropriate legal interpretation of the relevant provisions of the Act. Nevertheless, we believe it is appropriate to review our regulations governing eligibility and scope of financing for farmers and our definition of "moderately priced" rural housing. The goal of this rulemaking is to explore how our regulations can become more responsive to the needs of all eligible and creditworthy farmers and rural residents within the boundaries of the Act.

II. Background

A. Farmers

Section 1.9 of the Act authorizes FCS mortgage lenders to extend credit to "bona fide farmers, ranchers, or producers or harvesters of aquatic products." Section 1.11(a)(1) of the Act states that "Loans made by a Farm Credit [mortgage lender] to farmers, ranchers, and producers or harvesters of aquatic products may be for any agricultural or aquatic purpose and other credit needs of the applicant. . . ." Similarly, section 2.4(a)(1) authorizes certain FCS associations to "make, guarantee, or participate with other lenders in short- and intermediate-term loans and other similar financial assistance to . . . bona fide farmers and ranchers and the producers or harvesters of aquatic products, for agricultural or aquatic purposes and other requirements of such borrowers. . . ."

Under § 613.3000(a)(1), a "bona fide farmer or rancher" is "a person owning agricultural land or engaged in the production of agricultural products . . . ." The scope of financing regulation, § 613.3005, which the petitioners asked us to repeal, states:

> It is the objective of each bank and association, except for banks for cooperatives, to provide full credit, to the extent of creditworthiness, to the full-time bona fide farmer (one whose primary business and vocation is farming, ranching, or producing or harvesting aquatic products); and conservative credit to less than full-time farmers for agricultural enterprises, and more restricted credit for other credit requirements as needed to ensure a sound credit package or to accommodate a borrower's needs as long as the total credit results in being primarily an agricultural loan. However, the part-time farmer who needs to seek off-farm employment to supplement farm income or who desires to supplement off-farm income by living in a rural area and is carrying on a valid agricultural operation, shall have availability

> of credit for mortgages, other agricultural purposes, and family needs in the preferred position along with full-time farmers. Loans to farmers shall be on an increasingly conservative basis as the emphasis moves away from the full-time bona fide farmer to the point where agricultural needs only will be financed for the applicant whose business is essentially other than farming. Credit shall not be extended where investment in agricultural assets for speculative appreciation is a primary factor.

B. Non-Farm Rural Housing

Existing § 613.3030(a)(4) establishes two methods that FCS lenders may use to determine whether rural housing is "moderately priced." The first method derives from section 8.0(1)(B) of the Act, which defines "moderate priced" for the purpose of secondary market financing as dwellings (excluding the land) that do not exceed $100,000, as adjusted for inflation. The second method authorizes FCS banks and associations to determine whether housing in a particular rural area is "moderately priced" by documenting data from a credible, independent, and recognized national or regional source. Housing values at or below the 75th percentile are deemed to be moderately priced.

III. Questions

This rulemaking gives you the opportunity to tell us whether and how we should change our eligibility and scope of financing regulations for eligible farmers. We want to know if you think we should change the eligibility criteria for farmers as defined in § 613.3000. In addition, we seek your input on whether we should repeal, retain, or amend the scope of financing requirements in § 613.3005. We are particularly interested in your views on how we should regulate FCS lending for farmers' other credit needs. Please respond to the following questions.

1. Current § 613.3000(a)(1) defines a bona fide farmer, rancher, or aquatic producer as a person who either owns agricultural land or is engaging in the production of agricultural products. Do you think the FCA should retain or change this definition? If you favor changing this definition, please offer specific recommendations.

2. What limits, if any, should FCA regulations place on lending for farmers' other credit needs?

3. How should we regulate access to the other credit needs of eligible farmers who derive most of their income from off-farm sources? Do you favor retaining the current regulatory distinction between full-time and part-time farmers? If not, what would be a better approach?

4. Should we change our definition of "moderately priced" rural housing in § 613.3030(a)(4)? If you favor changing the definition, please offer specific recommendations.

The FCA welcomes other ideas or suggestions you may have about our eligibility and scope of financing regulations for eligible farmers and our regulations defining "moderately priced" rural housing.

The FCA also plans to conduct a public meeting on eligibility and scope of financing for eligible farmers and our definition of "moderately priced" rural housing. We will publish a separate notice in the Federal Register that will provide interested parties more information about the public meeting.

Dated: April 29, 2003

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

68 FR 23426, 05/02/2003

Handbook Mailing HM-03-11

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC20

Eligibility and Scope of Financing

AGENCY: Farm Credit Administration.

ACTION: Notice of public meeting.

SUMMARY: The Farm Credit Administration (FCA or agency) announces a public meeting to hear your views about whether and how we should revise our regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who borrow from Farm Credit System institutions that operate under titles I or II of the Farm Credit Act of 1971, as amended (Act) and our definition of "moderately priced" rural housing.

DATES: The public meeting will be held on June 26, 2003, in McLean, Virginia, 22102-5090 (703) 883-4056.

ADDRESSES: The FCA will hold the public meeting at our headquarters location at 1501 Farm Credit Drive, McLean, Virginia at 9:00 a.m. Eastern Daylight Savings Time. You may submit requests to appear and present testimony for the public meeting by electronic mail to "reg-comm@fca.gov," through the Pending Regulations section of FCA's Web site, "www.fca.gov," or through the government-wide "www.regulations.gov" portal. You may also submit requests to Robert E. Donnelly, Acting Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by facsimile to (703) 734-5784.

FOR FURTHER INFORMATION CONTACT:

Mark L. Johansen, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Richard Katz, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Background

We started this rulemaking in response to two petitions that asked us to repeal the scope of financing regulations in § 613.3005. One petitioner also asked us to modify our definition of "moderately priced" rural housing in § 613.3030(a)(4). The goal of this rulemaking is to explore how our regulations can become more responsive to the needs of all eligible ranchers, and aquatic producers or harvesters (collectively referred to as "farmers") and non-farm rural residents within the boundaries of the Act. We are publishing an Advance Notice of Proposed Rulemaking (ANPRM) in this issue of the Federal Register. In this document, we are announcing that we will hold a public meeting so you have another forum to present your views to us.

II. Topics

At the hearing, we will ask that you answer the same questions we asked in the ANPRM:

1. Current § 613.3000(a)(1) defines a bona fide farmer, rancher, or aquatic producer as a person who either owns agricultural land, or is engaging in the production of agricultural products. Do you think the FCA should retain or change this definition? If you favor changing this definition, please offer specific recommendations.

2. What limits, if any, should FCA regulations place on lending for farmers' other credit needs?

3. How should we regulate access to the other credit needs of eligible farmers who derive most of their income from off-farm sources? Do you favor retaining the current regulatory distinction between full-time and part-time farmers? If not, what would be a better approach?

4. Should we change our definition of "moderately priced" rural housing in § 613.3030(a)(4)? If you favor changing the definition, please offer specific recommendations.

III. Request To Present Testimony

Anyone wishing to present testimony in person may notify us by June 21, 2003, or register to speak on the day of the meeting. A request to speak should provide the name, address, and telephone number of the person wishing to testify and the general nature of the testimony. Requests to provide testimony in person will be honored in order of receipt.

Parties who register to speak on the day of the meeting may be invited to provide their testimony if time permits. If more people wish to testify than time permits, we will accept written statements for the record for 30 calendar days following the date of the public meeting.
Please limit oral testimony at the meeting to 10 minutes per person and allow 5 minutes for follow-up questions. At the public meeting, we will also accept, for the record, written comments on questions and issues raised in the ANPRM or any other comments that attendees may have on the subject of eligibility and scope of financing for farmers, ranchers, and aquatic producers and harvesters and the definition of "moderately priced" rural housing.
You may also wish to submit written statements or detailed summaries of the text of your testimony. Written comments that you wish to submit to supplement your testimony should be presented to us by the close of the public meeting.

Written copies of the testimony, along with a recorded transcript of the proceedings, will be included in our official public record. A transcript of the public meeting and any written statements submitted to the agency will be available for public inspection at our office in McLean, Virginia.

IV. Special Accommodations

The meeting is accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be received by FCA's Office of Communications and Public Affairs at (703) 883-4056, (TTY (703) 883-4056) by June 21, 2003.

Dated: April 29, 2003

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

68 FR 44490, 07/29/2003

Handbook Mailing HM-03-15

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 613

RIN 3052-AC20

Eligibility and Scope of Financing

AGENCY: Farm Credit Administration.

ACTION: Proposed rule; extension of comment period.

SUMMARY: The Farm Credit Administration (FCA) is extending the comment period on our Advance Notice of Proposed Rulemaking concerning eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters, and "moderately priced" rural housing. We are extending the comment period so all interested parties have more time to respond to our questions.

DATES: Please send your comments to the FCA by October 29, 2003.

ADDRESSES: We encourage you to send comments by electronic mail to "reg-comm@fca.gov," through the Pending Regulations section of FCA's Web site, "www.fca.gov," or through the government-wide "www.regulations.gov" portal. You may also send comments to S. Robert Coleman, Director, Regulation and Policy Division, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090 or by facsimile to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Mark L. Johansen, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434.

Or

Richard A. Katz, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION: On May 2, 2003, FCA published a notice in the *Federal Register* seeking public comment on whether it should revise its regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who borrow from Farm Credit System institutions that operate under titles I or II of the Farm Credit Act of 1971, as amended. In addition, we requested public comment on whether we should modify our regulatory definition of "moderately priced" rural housing. The comment period expires on July 31, 2003. *See* 68 FR 23425, May 2, 2003.

We also held a public meeting on June 26, 2003, to hear views from the public about whether and how we should revise our regulations governing eligibility, scope of financing, and "moderately priced" rural housing. After the public meeting two members of the public requested that we extend the comment period for an additional 90 days. In response to this request, we are extending the comment period until October 29, 2003, so all interested parties have more time to respond to our questions. The FCA supports public involvement and participation in its regulatory and policy process and invites all interested parties to review and provide comments on our notice.

Dated: July 23, 2003

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

69 FR 12694, 03/17/2004

Handbook Mailing HM-04-5

[6705-01-P]

FARM CREDIT ADMINISTRATION

Systematic Collection of Standardized Loan Data

AGENCY: Farm Credit Administration.

ACTION: Notice with request for comment.

SUMMARY: The Farm Credit Administration (FCA or agency) is seeking public input on the changes it should consider making to its systematic collection of standardized loan data. The agency currently collects basic descriptive information from Farm Credit System (FCS or System) banks and associations, in a standardized format, using the Loan Account Reporting System–Modified (LARS-M). The agency is planning to reengineer its collection of standardized loan data to meet its current and future information needs. In support of this reengineering project, FCA is seeking public comment on changes the agency should consider making to the loan data it collects; what processes and technological approaches to employ when collecting loan data; how to minimize the reporting burden on System institutions while meeting agency needs; and what types of standardized reports to make available to the general public and System institutions.

DATES: Please send your comments to the FCA by May 3, 2004.

ADDRESSES: We encourage you to send comments by electronic mail to "reg-comm@fca.gov" or through the Pending Regulations section of FCA's Web site, "www.fca.gov." You may also send comments to Andrew Jacob, Assistant Director, Office of Policy and Analysis, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090 or by facsimile to (703) 734-5784. You may review copies of all comments we receive at our office in McLean, Virginia.

FOR FURTHER INFORMATION CONTACT:

Gaylon J. Dykstra, Policy Analyst, Office of Policy and Analysis, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4073, TTY (703) 883-4434.

or

Howard Rubin, Senior Attorney, Office of the General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4029, TTY (703) 883-2020.

SUPPLEMENTARY INFORMATION:

I. Background

A. <u>What is LARS-MLoan Data Does FCA Collect</u>?

FCA currently collects certain standardized loan information from FCS banks and associations using the LARS-M. Examples of standardized variables collected include:

1. The date the loan was originated and the date on which it matures;

2. The primary agricultural commodity produced by the borrower;

3. Whether a loan is covered by a government guarantee;

4. If a loan is past due, the number of days the loan payment is delinquent;

5. The risk of the loan based on the uniform classification system as defined in the FCA Examination Manual (EM-320); and

6. Whether the borrower is in bankruptcy or the loan is in foreclosure status.

The agency also obtains direct institution-specific loan data as needed for examination purposes.

B. <u>How Does FCA Use Loan Data</u>?

FCA uses loan information to support its supervision and regulation of System institutions. For supervisory purposes, loan information is important for evaluating portfolio risk associated with agricultural lending and analyzing credit risks in individual agricultural loans. Loan data are also required for monitoring Systemwide trends and emerging vulnerabilities. For regulatory purposes, loan information is used for developing regulations and other public policy actions. FCA also uses loan data in fulfilling reporting requirements and informational requests.

C. <u>Identifying Loan Portfolio Risk</u>

Identification of risks in a loan portfolio is essential to FCA's evaluation of an institution's safety and soundness. Loan portfolio risk reflects individual loan exposures and the combined effects on a portfolio. Risk in individual loans is a function of characteristics associated with a borrower's agricultural operation and financial condition and performance. Examples of loan characteristics include the commodities produced, geographic location, payment history, financial strength, and off-farm income. These types of loan data are important determinants of the credit risk of a loan. Therefore, FCA access to loan data is critical for evaluating portfolio risks of System institutions and the credit risk of individual loans.

D. <u>Monitoring Systemwide Trends</u>

Analyzing Systemwide trends and emerging vulnerabilities is a critical agency activity for monitoring the overall mission accomplishment and ongoing safety and soundness of the FCS. Monitoring Systemwide trends helps FCA identify when risks are impacting the System's agricultural loans. For example, the System may show an overall increase in delinquent loans. Access to loan data allows the agency to analyze this trend and associated characteristics, such as geographic location, commodity linkage, or other commonalities among affected institutions. Similarly, the agency uses loan data to analyze the impact of emerging vulnerabilities, such as food safety concerns, trade disputes, changes in government support programs, shifts in consumer preferences, and climactic events. Using loan data, the agency can better identify vulnerable System loans. Access to loan data increases FCA's understanding of the systemic risks facing the FCS and helps the agency determine if any policy actions are needed.

E. Developing Regulations and Policy

FCA uses loan data to support its regulation of System institutions. For example, loan data provide information needed to evaluate the impact of capital adequacy standards, lending limits, and liquidity requirements. Moreover, access to loan data allows the agency to analyze the effectiveness and results achieved from regulations and policy actions.

F. Fulfilling Reporting Requirements and Responding to Information Requests

The agency is required to periodically provide reports to Congress. The agency also frequently responds to information requests from Congress and others. Ready access to loan data aids FCA in timely and accurately responding to reporting requirements and information requests.

G. Why is FCA Considering ChangingLARS-M its Standardized Collection of Loan Data?

LARS-M was first implemented in 1987 and last revised in 1993. While LARS-M provides FCA with a standardized and centralized collection of loan data, it has not kept pace with changes in financial reporting systems, is incomplete as to loan types, lacks detail, and only allows access to current quarter data. FCA, therefore, believes improvements are needed to fully meet the agency's current and future information needs.

FCA examiners also obtain loan information directly from System institutions on an ad hocas-needed basis for use in conducting examinations, but this information is not standardized or centralized. As a result, directly downloaded data are not useful or available for Systemwide analysis or reporting. More importantly, the downloaded data vary considerably by FCA field office since loan information systems vary across System institutions. Therefore, standardized and centralized collection of loan data would help overcome the variety in electronic loan information systems used by FCS institutions.

II. Objectives of This Project

The objectives of FCA's project to reengineer its standardized collection of loan data from System institutions are to:

1. Determine the appropriate set of loan data to collect on a systematic, centralized, and standardized basis that meets the agency's needs;

2. Streamline the collection process of loan data to enhance reliability, timeliness, and data accuracy;

3. Minimize the reporting burden on System institutions; and

4. Provide appropriate standardized reports to internal and, potentially, external parties.

The reengineering project will address the limitations of the current approach to a standardized collection of loan data. The agency is already considering the data elements it needs to collect on individual loans, including what specific financial information, loan performance data, and other essential information about loan characteristics that are necessary for adequately evaluating portfolio and loan risks. Moreover, the project will also address the agency's need to collect information for all loans made by System institutions. Along with these considerations, the agency is evaluating the data elements needed to model loan performance characteristics through time, such as probability of default, loss severity, and exposures at default. In the future, modeling loan performance may become a key aspect in the evaluation of a System institution's capital adequacy. FCA is also evaluating new technologies to streamline and improve the collection process. This evaluation includes reducing the reporting burden by relying on an efficient process that utilizes information readily available in the different FCS institutions' electronic loan information systems.

FCA is also evaluating the standardized reports the agency currently uses in conducting its supervisory and regulatory programs, including considering the type of reports to make available to the general public and System institutions in light of legal restrictions and other constraints regarding the release of private and sensitive business information used solely for examination purposes.

III. Questions

To augment the agency's experience and expertise with agricultural lending practices and credit analysis, FCA is seeking public input on the changes it should consider making as it reengineers the systematic collection of standardized loan data from System institutions. Specifically, the agency requests comments on:

1. What suggestions do you have regarding loan data elements?

2. What processes and technological approaches to employ to streamline the collection of loan data?

3. How to minimize the reporting burden on System institutions while meeting the agency's informational needs?

4. What standardized reports to make available to the general public and System institutions, considering the need to protect private and proprietary confidential information?

Along with these questions, we welcome any other comments or suggestions the agency should consider as it moves forward with this initiative.

Date: March 12, 2004

Jeanette C. Brinkley,
Secretary,
Farm Credit Administration Board.

72 FR 61568, 10/31/2007

Handbook Mailing HM-07-8

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052-AC25

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Capital Adequacy--Basel Accord

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking (ANPRM).

SUMMARY: The Farm Credit Administration (FCA or we) is considering possible modifications to our risk-based capital rules for Farm Credit System institutions (FCS or System) that are similar to the standardized approach delineated in the New Basel Capital Accord. We are seeking comments to facilitate the development of a proposed rule that would enhance our regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. We are also withdrawing our previously published ANPRM.

DATES: You may send comments on or before March 31, 2008.

ADDRESSES: We offer several methods for the public to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed, as faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or on our Web site at http://www.fca.gov. Once you are in the Web site, select “Legal Info,” and then select “Public Comments.” We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Laurie Rea, Associate Director, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4232, TTY (703) 883-4434,

or

Wade Wynn, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4262, TTY (703) 883-4434,

or

Rebecca S. Orlich, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objective of this ANPRM is to gather information to facilitate the development of a comprehensive proposal that would:

1. Promote safe and sound banking practices and a prudent level of regulatory capital for System institutions;[1]

2. Improve the risk sensitivity of our regulatory capital requirements while avoiding undue regulatory burden;

3. To the extent appropriate, minimize differences in regulatory capital requirements between System institutions and federally regulated banking organizations;[2] and

4. Foster economic growth in agriculture and rural America through the effective allocation of System capital.

In addition, we are withdrawing our previous ANPRM on capital, published in the Federal Register on June 21, 2007 (72 FR 34191), as described more fully below.

II. Background

The FCA’s risk-based capital requirements for System institutions are contained in subparts H and K of part 615 of our regulations.[3] Our risk-based capital framework is based, in part, on the “International Convergence of Capital Measurement and Capital Standards” (Basel I) as published by the

Basel Committee on Banking Supervision (Basel Committee)[4] and is broadly consistent with the capital requirements of the other Federal financial regulatory agencies.[5] We first adopted a risk-based capital framework for the System as part of our 1988 regulatory capital revisions[6] required by the Agricultural Credit Act of 1987[7] and made subsequent revisions in 1997,[8] 1998[9] and 2005.[10] Under the current capital framework, each on- and off-balance sheet credit exposure is assigned to one of five broad risk-weighting categories to determine the risk-adjusted asset base, which is the denominator for computing the permanent capital, total surplus, and core surplus ratios.

For a number of years, the Basel Committee has worked to develop a more risk sensitive regulatory capital framework that incorporates recent innovations in the financial services industry. In June 2004, it published the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II) to promote improved risk measurement and management processes and more closely align capital requirements with risk.[11] Basel II has three pillars: 1) Minimum capital requirements for credit risk, operational risk, and market risk, 2) supervision of capital adequacy, and 3) market discipline through enhanced public disclosure. Banking organizations have various options for calculating the minimum capital requirements for credit and operational risk. For credit risk, the options are the standardized approach, the foundation internal ratings-based approach, and the advanced internal ratings-based approach (A-IRB). For operational risk, the options are the basic indicator approach, the standardized approach, and the advanced measurement approach (AMA).

In September 2006, the other Federal financial regulatory agencies issued an interagency notice of proposed rulemaking for implementing the advanced approaches of Basel II in the United States (the advanced capital framework).[12] This advanced capital framework would require core banks[13] and permit opt-in banks[14] to use the A-IRB[15] to calculate the regulatory capital requirement for credit risk and the AMA[16] to calculate the regulatory capital requirement for operational risk.[17]

Given the small number of core banks and the complexity and cost associated with voluntarily adopting the advanced approaches, only a small number of U.S. banking organizations are expected to implement the advanced capital framework. As a result, a bifurcated regulatory capital framework will be created in the United States, which could result in different regulatory capital charges for similar products offered by those that apply the advanced capital framework and those that do not. Financial regulators, banking organizations, trade associations and other interested parties have raised concerns that the bifurcated structure could create a significant competitive disadvantage for those that do not apply the advanced capital framework.

In December 2006, the other Federal financial regulatory agencies addressed these concerns by issuing an interagency notice of proposed rulemaking (Basel IA) to improve the risk sensitivity of the existing Basel I-based capital framework.[18] Subsequently, the FCA issued an ANPRM,[19] published in June 2007, addressing issues similar to those addressed in Basel IA. Basel IA was intended to help minimize the potential differences in the regulatory minimum capital requirements of those banks applying the advanced capital framework and those banks that would not. The other Federal financial regulatory agencies received a significant number of comments opposing their Basel IA proposal. Many commenters argued that the benefits of complying with Basel IA did not outweigh the burdens, and many questioned why the U.S. banking agencies were creating a separate rule that had only minor differences from the standardized approach under Basel II. On July 20, 2007, the other Federal financial regulatory agencies announced that they intended to replace the Basel IA proposal with a proposed rule that would provide all non-core banks the option to adopt the standardized approach under Basel II.[20] Their stated intent is to finalize a standardized approach for banks that do not adopt the advanced approaches before the core (and opt-in) banks begin their first transition period year under the advanced approaches of Basel

II.

The other Federal financial regulatory agencies plan to replace Basel IA with a proposed rule patterned after the standardized approach under Basel II. Consequently, we are withdrawing our previous ANPRM and replacing it with one that is also consistent with the standardized approach. We intend to develop a proposed rule that is similar to the capital requirements of the other Federal financial regulatory agencies where appropriate but also tailored to fit the System's distinct borrower-owned lending cooperative structure and Government-sponsored enterprise (GSE) mission.

The questions posed in this ANPRM are, for the most part, similar to the questions we asked in our previous ANPRM.[21] We have revised the technical material in most places to conform to the standardized approach of Basel II. For example, we replaced the risk-weight categories that were in the Basel IA proposed rule with the risk-weight categories that are contained in the standardized approach under Basel II. We ask commenters to consider the revised material when answering the following questions. We seek comments from all interested parties to help us develop a comprehensive proposal that would enhance our regulatory capital framework and increase the risk sensitivity of our risk-based capital rules without unduly increasing regulatory burden.

III. Questions

When addressing the following questions, we ask commenters to consider the overarching objectives of Basel II to more closely align capital with the specific risks taken by the financial institution rather than relying on a "one-size-fits-all" approach for determining regulatory minimum risk-based capital requirements. Our objective is to develop a more dynamic risk-based capital framework that is more sensitive to the relative risks inherent in System lending and other mission-related activities. We seek comments on specific criteria that might be used to determine appropriate risk weights that meet this objective without creating undue burden. Specifically, we ask that you support your comments with data, to the extent possible, in response to our questions.[22]

A. Increase the Number of Risk-Weight Categories

Our existing risk-based capital rules assign exposures to one of five risk-weight categories: 0, 20, 50, 100, and 200 percent.[23] The standardized approach of Basel II adds risk-weight categories of 35, 75, and 150 percent and replaces the 200-percent risk-weight category with a 350-percent risk-weight category.[24] The 35-percent risk-weight category would apply to certain residential mortgages. The 75-percent risk-weight category would apply to certain retail claims (e.g., small business loans). The 150-percent and 350-percent risk-weight categories would apply to certain higher risk externally rated exposures (e.g., those below investment grade).

Question 1: We seek comment on what additional risk-weight categories, if any, we should consider for assigning risk weights to System institutions' on- and off-balance sheet exposures. If additional risk-weight categories are added, what assets should be included in each new risk-weight category?

B. Use of External Credit Ratings to Assign Risk-Weight Exposures

1. Direct Exposures

In recent years, the FCA has permitted System institutions to use external ratings to assign risk weights to certain credit exposures linked to nationally recognized statistical rating organizations (NRSROs) ratings.[25] For example, in March 2003, we adopted an interim final rule that permitted System institutions to use NRSRO ratings to place highly rated investments in non-agency asset-backed securities (ABS) and mortgage-backed securities (MBS) in the 20-percent risk-weight category.[26] In April 2004, we expanded the use of NRSRO ratings to assign risk weights to loans to other financing institutions.[27] In June 2005, we adopted a ratings-based approach to assign risk weights to recourse obligations, direct credit substitutes (DCS), residual interests (other than credit-enhancing interest-only strips), and other ABS and MBS investments.[28] Furthermore, we recently permitted the use of NRSRO ratings to assign risk weights to certain electric cooperative credit exposures.[29]

The standardized approach of Basel II expands the use of NRSRO ratings to determine the risk-based capital charge for long-term exposures to sovereign entities, non-central government public sector entities (PSEs), banks[30], corporate entities, and securitizations as displayed in Table 1 set forth below.[31]

Table 1 – The Standardized Approach Risk Weights Based on External Ratings for Long-Term Exposures

Credit Assessment	Sovereign Risk Weight (in percent)	PSE and Bank* Risk Weights (in percent)		Corporate Risk Weight (in percent)	Securitization**Risk Weight (in percent)
		Option 1	Option 2		
AAA to AA-	0	20	20	20	20
A+ to A-	20	50	50	50	50
BBB+ to BBB-	50	100	50	100	100
BB+ to BB-	100	100	100	100	350
B+ to B-	100	100	100	150	Deduction ***
Below B-	150	150	150	150	Deduction ***
Unrated	100	100	50	100	Deduction ***

* The Standardized Approach provides two options for PSEs and bank exposures: (1) Option 1 assigns a risk weight one category below that of sovereigns; (2) Option 2 assigns a risk weight based on the individual bank rating. Option 2 also provides risk weights for short-term claims as follows: (1) AAA to BBB- and unrated = 20 percent; (2) BB+ to B- = 50 percent; and (3) Below B- = 150 percent.

** Short-term rating categories are as follows: (1) A-1/P-1 = 20 percent; (2) A-2/P-2 = 50 percent; (3) A-3/P-3 = 100 percent; and (4) All other ratings or unrated = Deduction.

*** Banks must deduct the entire amount from capital. However, if banks originate a securitization and the most senior exposure is unrated, the bank may use the "look through" treatment, which is the average risk weight of the underlying exposures subject to supervisory review.

System institutions provide financing to agriculture and rural America through a variety of lending[32] and investment[33] products. They also hold highly rated liquid investments to manage liquidity, short-term surplus funds, and interest rate risk. Our existing risk-based capital rules assign most agricultural and rural business[34] loans and mission-related investment assets to the 100-percent risk-weight category unless the risk exposure is mitigated by an acceptable guarantee or collateral. The FCA is considering the expanded use of NRSRO ratings to assign risk weights to other externally rated credit exposures in the System, such as corporate debt securities and loans.

Question 2: We seek comments on all aspects of the appropriateness of using NRSRO ratings to assign risk weights to credit exposures. If we expand the use of external ratings, how should we align the risk-weight categories with NRSRO ratings to determine the appropriate capital charge for externally rated credit exposures? Should any externally rated positions be excluded from this new ratings-based approach? We ask commenters to consider the substantial reliance on NRSRO ratings as a means of evaluating the quality of debt investments in view of recent events in the subprime mortgage market.

2. Recognized Financial Collateral

Our current risk-based capital rules assign lower risk weights to exposures collateralized by: (1) Cash held by a System institution or its funding bank; (2) securities issued or guaranteed by the U.S. Government, its agencies or Government-sponsored agencies; (3) securities issued or guaranteed by central governments in other OECD[35] countries; (4) securities issued by certain multilateral lending or regional development institutions; or (5) securities issued by qualifying securities firms.

The standardized approach of Basel II has two methods for recognizing a wider variety of collateral types for risk-weighting purposes.[36] Under the simple approach, the collateralized portion of the exposure would be assigned a risk weight (as listed in Table 1) according to the external rating of the collateral. The remainder of the exposure would be assigned a risk weight appropriate to the counterparty. Collateral would be subject to a 20-percent floor unless the collateral is cash, certain government securities or repurchase agreements, and it would be marked-to-market and revalued every 6 months. Securities issued by sovereigns or PSEs must be rated at least BB- or its equivalent by a NRSRO. Securities issued by other entities must be rated at least BBB- or its equivalent by an NRSRO. Short-term debt instruments used as collateral must be rated at least A-3/P-3 or its equivalent by an NRSRO.

Under the comprehensive approach, the banking organization adjusts the value of the exposure by the discounted value of the collateral. Discount values, known as supervisory haircuts, are displayed in Table 2 set forth below. For example, sovereign debt rated A+ with a 5-year maturity used as collateral is discounted by 3 percent, and corporate debt rated A+ with a 5-year maturity is discounted at 6 percent.

<u>Table 2 – Standard Supervisory Haircuts in the Comprehensive Approach for Credit Mitigation</u>

Issue rating for debt securities	Residual maturity	Sovereigns and PSEs* (in percent)	Other issuers** (in percent)
AAA to AA- or A-	≤ 1 year	0.5	1
	> 1 year, ≤ 5 years	2	4
	> 5 years	4	8
A+ to BBB- or A-2/A-3/P-3	≤ 1 year	1	2
	> 1 year, ≤ 5 years	3	6
	> 5 years	6	12
BB+ to BB-	All	15	

* Includes PSEs treated as sovereigns
** Includes PSEs not treated as sovereigns

Question 3: We seek comment on whether recognizing additional types of eligible collateral would improve the risk sensitivity of our risk-based capital rules without being overly burdensome. We also seek comment on what additional types of collateral, if any, we should consider and what effect the collateral should have on the risk weighting of System exposures.

3. Eligible Guarantors

Our existing capital rules permit the use of third party guarantees to lower the risk weight of certain exposures. Guarantors include: (1) The U.S. Government, its agencies or Government-sponsored agencies; (2) U.S. state and local governments; (3) central governments and banks in OECD countries; (4) central governments in non-OECD countries (local currency exposures only); (5) banks in non-OECD countries (short-term claims only); (6) certain multilateral lending and regional development institutions; and (7) qualifying securities firms.

The standardized approach of Basel II expands the range of eligible guarantors to include sovereign entities, PSEs, banks and securities firms that have a lower risk weight than the counterparty.[37] All other guarantors must be rated A- (or its equivalent) or better by a NRSRO. The guarantee must: (1) Represent a direct claim on the protection provider, (2) be explicitly referenced to specific exposures or pools of exposures, (3) be irrevocable, and (4) unconditional. The guarantor's risk weight would be substituted for the risk weight assigned to the exposure. Non-guaranteed portions of the exposure would be assigned to the external rating of the exposure.

Question 4: We seek comment on what additional types of third party guarantees, if any, we should recognize and what effect such guarantees should have on the risk weighting of System exposures.

C. Direct Loans to System Associations

The FCA is considering ways to better align our risk-based capital requirements for direct loans with System associations. System banks make direct loans to their affiliated associations who, in turn, make retail loans to eligible borrowers. Our current risk-based capital rules assign a 20-percent risk weight to direct loans at the bank level and another risk weight (depending upon the type of loan) to retail loans at the association level.[38] The 20-percent risk weight is intended to recognize the risks to the banks associated with lending to their affiliated associations. We are exploring methods to improve the risk sensitivity of our risk-based capital rules by assigning different risk weights to direct loan exposures based on the System association's distinct risk profile.

Question 5: We seek comment on what evaluative criteria or methods we should use to assign risk weights to direct loans to System associations. How should the criteria be used to adjust the risk weight as the quality of the direct loan changes over time?

D. Small Agricultural and Rural Business Loans

Our existing risk-based capital rules assign small agricultural and rural business loans to the 100-percent risk-weight category unless the credit risk is mitigated by an acceptable guarantee or acceptable collateral. The standardized approach of Basel II applies a 75-percent risk weight to certain retail claims[39] provided: (1) The exposure is to an individual person or persons or to a small business, (2) the exposure is in the form of a revolving credit, line of credit, personal term loan or lease, or small business facility or commitment, (3) the regulatory supervisor is satisfied that the retail portfolio is sufficiently diversified to warrant such a risk weight, and (4) the total credit exposure to the borrower does not exceed approximately $1.4 million.[40]

Question 6: We seek comment on what approaches we should use to improve the risk sensitivity of our risk-based capital rules for small agricultural and rural business loans. More specifically, what criteria should we use to classify an agricultural or rural business as a small business? What criteria should we use to assign risk-weights of less than 100 percent to these types of loans?

E. Loans Secured by Liens on Real Estate

The FCA is considering ways to use loan-to-value ratios (LTV) and other criteria to determine the risk-based capital charges for farm real estate and qualified residential loans. Our existing capital rules assign farm real estate loans to the 100-percent risk-weight category and qualified residential loans[41] to the 50-percent risk-weight category. The standardized approach of Basel II assigns a 35-percent risk weight to all prudently underwritten residential mortgages. Basel IA had proposed to risk-weight loans secured by first and second liens on residential real estate based on LTV. We continue to believe that LTV is a viable option for determining appropriate risk-weights for farm real estate and qualified residential loans. We are also considering approaches that would combine borrower creditworthiness and other loan characteristics in conjunction with LTV.

Question 7: We seek comment on all aspects of using LTV to determine the appropriate risk-weight for farm real estate, qualified residential loans, or any other asset class. We also welcome comments on other methods that could be used to improve the risk sensitivity of our risk-based capital rules for these types of loans.

F. Loans 90 Days or More Past Due or in Nonaccrual[42]

Our existing risk-based capital rules assign most loans to the 100-percent risk-weight category unless the credit risk is mitigated by an acceptable guarantee or collateral. When exposures reach 90 days or more past due or are in nonaccrual status, there is a higher probability that the financial institution might incur a loss. The standardized approach of Basel II addresses this potentially higher risk of loss by assigning the unsecured portion of a loan that is 90 days or more past due (net of specific provisions) as follows:

- 150-percent risk weight when specific provisions are less than 20 percent of the outstanding amount of the loan;
- 100-percent risk weight when specific provisions are 20 percent or more of the outstanding amount of the loan;
- When specific provisions are 50 percent or more of the outstanding amount of the loan, the supervisor has the discretion to reduce the risk weight to 50 percent.

Question 8: We seek comment on all aspects related to risk-weighting exposures that reach 90 days or more past due or are in nonaccrual status.

G. Short- and Long-Term Commitments

Under § 615.5212, off-balance sheet commitments are generally risk-weighted in two steps: (1) The off-balance sheet commitment is multiplied by a credit conversion factor (CCF)[43] to determine its on-balance sheet credit equivalent; and (2) the on-balance sheet credit equivalent is assigned to the appropriate risk-weight category in § 615.5211 according to the obligor, after considering any applicable collateral and guarantees.[44] The standardized approach of Basel II assigns a 0-percent CCF to unconditionally cancelable commitments,[45] a 20-percent CCF to short-term commitments, and a 50-percent CCF to long-term commitments.[46]

Question 9: We seek comment on what approaches we should use to risk weight short- and long-term commitments that are not unconditionally cancelable.

H. Adjusting Risk Weights on Exposures over Time

The FCA welcomes comment on additional approaches or criteria that might be used to adjust the risk weight of exposures throughout the life of the asset. Our existing risk-based capital rules assign a static risk weight to assets within a given asset class without providing for risk-weight adjustments as asset quality improves or deteriorates. For example, most loans to System borrowers are risk-weighted at 100 percent throughout the life of the loan without making risk-weight adjustments based on credit classifications or other credit performance factors.

Question 10: We seek comment on what methods we should use to adjust the risk weight of credit exposures as the asset quality or default probability changes over time.

I. Capital Charge for Operational Risk

The FCA welcomes comments on possible approaches for determining a capital charge for operational risk. The broad risk-weighting categories under our existing capital rules are primarily designed to protect against credit or counterparty risk. As we move toward a more risk-sensitive capital framework, it may be appropriate to apply an explicit capital charge for operational risk, especially to cover risks associated with off-balance sheet activity.

Basel II defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people, systems, or from external events. This definition includes legal risk but excludes strategic and reputational risk. As previously mentioned, Basel II has three methods for applying a capital charge for operational risk. Under the basic indicator approach, the operational capital charge is equal to 15 percent of the 3-year average of positive annual gross income. Under the standardized approach, the operational capital charge is equal to the sum of a fixed percentage of the 3-year average of the gross income of eight business lines.[47] Under the AMA, the operational capital charge is derived from a bank's internal operational risk management systems and processes.

Question 11: We seek comment on what approach we should consider, if any, in determining a risk-based capital charge for operational risk.

J. Disclosure[48]

The FCA recognizes that market discipline contributes to a safe and sound banking environment and enhances risk management practices. Pillar III of Basel II is designed to complement the minimum capital requirements and supervisory review process by encouraging market discipline through meaningful public disclosure. The disclosure requirements are intended to allow market participants to assess key information about an institution's risk profile and associated level of capital to better evaluate risk management performance, earnings potential and financial strength.

Pillar III of Basel II presents the following general disclosure requirements: 1) Banks should have a formal disclosure policy approved by the board of directors that addresses the institution's approach for determining the disclosures it should make;[49] 2) banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency of them; 3) banks should decide which disclosures are relevant based on the materiality concept;[50] and 4) the disclosures should be made on a semi-annual basis, subject to certain exceptions.[51]

The other Federal financial regulatory agencies have proposed the following additional requirements in the advanced capital framework: 1) The disclosures would follow U.S. generally accepted accounting principles, SEC mandates, and existing regulatory reporting requirements; 2) the banks would be required to disclose quantitative information on a quarterly basis following SEC deadlines; 3) the disclosures would be made publicly available (for example, on a Web site) for each of the last 3 years (that is, 12 quarters);[52] 4) disclosure of key financial ratios must be provided in the footnotes to the year-end audited financial statements;[53] 5) the chief financial officer must certify that the disclosures are appropriate; and 6) the board of directors and senior management are responsible for establishing the internal control structure over financial reporting.

Question 12: We seek comment on all aspects of the Basel II public disclosure requirements. Specifically, how would the System apply the public disclosure requirements of Pillar III given its unique cooperative structure?

K. Capital Leverage Ratio

We are considering whether we should supplement our existing risk-based capital rules with a minimum capital leverage ratio requirement for all FCS institutions to further promote the safety and soundness of the System. Our existing capital regulations require System banks to maintain a minimum net collateral ratio (NCR)[54] of 103 percent[55] but do not impose a capital leverage ratio on System associations. The NCR provides a level of protection for operating and other forms of risk at System banks, but it does not differentiate higher quality from lower quality capital. The other Federal financial regulatory agencies currently supplement their risk-based capital rules with a leverage ratio of Tier 1 capital to total assets (Tier 1 leverage ratio).[56] The Tier 1 leverage ratio consists of only the most reliable and permanent forms of capital such as common stock, non-cumulative perpetual preferred stock, and retained earnings.

Question 13: We seek comment on whether our capital rules should include a minimum capital leverage ratio requirement for all System institutions. We also seek comment on changes, if any, that should be made to the existing regulatory minimum NCR requirement applicable to System banks that would make it more comparable to the Tier 1 ratio used by the other Federal financial regulatory agencies.

L. Regulatory Capital Directives[57]

We are considering whether we should modify our capital rules to specify potential early intervention criteria for the issuance of capital directives. Currently, FCA has the discretion to issue a capital directive[58] when an institution's capital is insufficient. The FCA, however, has not defined capital or other financial early intervention thresholds to require an institution to take corrective action as described in § 615.5355. Early intervention approaches have been used in other contexts, including the System's Market Access Agreement and the statutory requirements applicable to other regulated financial institutions.[59] An early intervention capital directive framework could provide a clearer indication of when we would impose additional and increasing supervisory oversight on an institution to address continuing deterioration in its financial condition and capital position from credit, interest rate, or other financial risks.

Question 14: We seek comment on revising our current capital directive regulations to include an early intervention framework. We also seek comment on potential financial thresholds, such as capital ratios or risk measures, that would trigger an FCA capital directive action.

M. <u>Multi-Dimensional Regulatory Structure</u>

As stated above, one of FCA's objectives is to implement a revised capital framework that improves the risk sensitivity of our capital rules while avoiding undue regulatory burden. There are currently five banks and 95 associations in the System with varying degrees of asset size, complexity of operations, and sophistication in their risk management practices. Some System institutions have the risk management capabilities to apply more complex, risk-sensitive regulatory capital requirements than other System institutions. It may be appropriate for the FCA to adopt more than one set of capital rules to account for these differences. However, this approach could result in different capital requirements for the same type of transaction and increase examination and oversight costs.

As described above, the other Federal financial regulatory agencies are in the process of proposing two sets of capital rules for the financial institutions they regulate. The implementation of the advanced capital framework would be limited, for the most part, to the largest, internationally active banks that meet certain infrastructure requirements. Other banks would implement a simpler capital framework patterned after the standardized approach of Basel II.
While our expectation is to implement a revised capital framework similar to the standardized approach of Basel II, we also recognize that some aspects of the advanced approaches may be appropriate for the larger, more complex System institutions. However, we are still reviewing the advanced approaches of Basel II and its potential application to the System. Therefore, we are not seeking comments on specific aspects of the advanced approaches at this time. Rather, we are considering the overall regulatory capital framework for the System in light of the changes occurring in the financial services industry and recent best practices for economic capital modeling.

Question 15: We seek comment on the most appropriate risk-based capital framework for the System and the reasons we should implement one framework over another. Should we consider creating a uniform regulatory capital structure for the System or a multi-dimensional regulatory structure and allow each System institution the option of choosing which capital framework it will apply? How might this new risk-based capital framework increase the costs or regulatory burden to the System? Would the increased costs be justified by improved risk sensitivity, risk management, and more efficient capital allocation?

N. <u>Reporting Requirements and Transition Period</u>[60]

The other Federal financial regulatory agencies have announced that they will be replacing Basel IA with a proposed rule that would provide all non-core banks the option of adopting the standardized approach under Basel II. Their stated intent is to finalize a standardized approach for non-core banks before the core banks begin their first transition period year under the advanced capital framework. Our objective is to minimize, to the extent possible, the time interval between the issuance of their final rule and ours. We also need a transition period to make appropriate modifications to the Call Reporting System to track the new risk-based capital requirements.

Question 16: We seek comment on an appropriate timetable for implementing our new risk-based capital rules. Specifically, what is an appropriate time interval between the issuance of the other Federal financial regulatory agencies' final rule on the standardized approach of Basel II and ours? How long should the transition period be to allow System institutions to adjust to the new risk-based *capital rules?*

Question 17: Additionally, we seek comment on any other methods that may be used to increase the risk sensitivity of our risk-based capital rules.

Dated: October 25, 2007

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

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[1]The System was created by Congress in 1916 and is the oldest GSE in the United States. System institutions provide credit and financially related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. They also make credit available for agricultural processing and marketing activities, rural housing, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and foreign and domestic entities in connection with international agricultural trade.

[2]Banking organizations include commercial banks, savings associations, and their respective bank holding companies.

[3]Our regulations can be accessed at http://www.fca.gov/index.html.

[4]The Basel Committee on Banking Supervision was established in 1974 by central banks with bank supervisory authorities in major industrialized countries. The Basel Committee formulates standards and guidelines related to banking and recommends them for adoption by member countries and others. All Basel Committee documents are available at http://www.bis.org.

[5]We refer collectively to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision as the "other Federal financial regulatory agencies."

[6]See 53 FR 39229 (October 6, 1988).

[7]Pub. L. 100-233 (January 6, 1988), section 301. The 1987 Act amended many provisions of the Farm Credit Act of 1971, as amended, which is codified at 12 U.S.C. 2001 et seq.

[8]See 62 FR 4429 (January 30, 1997).

[9]See 63 FR 39219 (July 22, 1998).

[10]See 70 FR 35336 (June 17, 2005).

[11]See www.bis.org/publ/bcbsca.htm for the 2004 Basel II Accord as well as updates in 2005 and 2006.

[12] See 71 FR 55830 (September 25, 2006). This document is at http://www.federalreserve.gov/generalinfo/basel2/USImplementation.htm.

[13] Core banks are banking organizations that have consolidated total assets of $250 billion or more or have consolidated on-balance sheet foreign exposures of $10 billion or more.

[14] Opt-in banks are banking organizations that do not meet the definition of a core bank but have the risk management and measurement capabilities to voluntarily implement the advanced approaches of Basel II with supervisory approval.

[15] A banking organization computes internal estimates of certain key risk parameters for each credit exposure or pool of exposures and feeds the results into regulatory formulas to determine the risk-based capital requirement for credit risk.

[16] Internal operational risk management systems and processes are used to compute risk-based capital requirements for operational risk.

[17] The other Federal financial regulatory agencies also seek comments on whether core and opt-in banks should be permitted to use other credit and operational risk approaches.

[18] 71 FR 77446 (December 26, 2006). This document is at http://www.federalreserve.gov/generalinfo/basel2/USImplementation.htm.

[19] 72 FR 34191 (June 21, 2007).

[20] Joint Press Release, "Banking Agencies Reach Agreement On Basel II Implementation," (July 20, 2007). This document is at http://www.occ.gov/ftp/release/2007-77.htm.

[21] Questions 1, 3, 4, 5, 9 and 10 in this ANPRM are identical to those numbered questions posed in our previous ANPRM. Questions 2, 6 and 11 are slightly different. Question 7 in this ANPRM replaces Questions 7 and 8 in our previous ANPRM. Questions 8, 12, and 16 are new to this ANPRM. Questions 13 through 15 are identical to Questions 12 through 14 in our previous ANPRM. Question 17 is identical to Question 15 in our previous ANPRM.

[22] Please note that any data you submit will be made available to the public in our rulemaking file.

[23] FCA's risk-weight categories are set forth in 12 CFR 615.5211.

[24] Basel IA proposed adding risk-weight categories of 35, 75, and 150 percent.

[25] A NRSRO is a credit rating organization that is recognized by and registered with the Securities and Exchange Commission (SEC) as a nationally recognized statistical rating organization. See 12 CFR 615.5201. See also Pub. L. 109–291.

[26] See 68 FR 15045 (March 28, 2003).

[27] Other financing institutions are non-System financial institutions that borrow from System banks. See 69

FR 29852 (May 26, 2004).

[28]These changes are consistent with those of the other Federal financial regulatory agencies. See 70 FR 35336 (June 17, 2005).

[29]See "Revised Regulatory Capital Treatment for Certain Electric Cooperatives Assets," FCA Bookletter BL-053 (February 12, 2007).

[30]Banks include multilateral development banks and securities firms.

[31]Basel IA proposed the categories sovereign entities, non-sovereign entities, and securitizations with different risk-weight categories.

[32]The Farm Credit Banks provide wholesale funding to their affiliated associations who, in turn, make retail loans to eligible borrowers. CoBank, ACB, provides both wholesale funding to its affiliated associations and retail loans to cooperatives and other eligible borrowers.

[33]System banks and associations are permitted to make mission-related investments to agriculture and rural America. See "Investments in Rural America—Pilot Investment Programs," FCA Informational Memorandum (January 11, 2005).

[34]Agricultural businesses include farmer-owned cooperatives, food and fiber processors and marketers, manufacturers and distributors of agricultural inputs and services, and other agricultural-related businesses. Rural businesses include electric utilities and other energy-related businesses, communication companies, water and waste disposal businesses, ethanol plants, and other rural-related businesses.

[35]OECD stands for the Organization for Economic Cooperation and Development. The OECD is an international organization of countries that are committed to democratic government and the market economy. An up-to-date listing of member countries is available at http://www.oecd.org or www.oecdwash.org.

[36]Basel IA proposed assigning lower risk weights to exposures collateralized by securities issued by sovereigns or non-sovereigns that were externally rated at least investment grade.

[37]Basel IA proposed to include guarantees from any entity that had long-term senior debt rated at least investment grade (or issuer rating if a sovereign).

[38]Our risk-based capital rules also assign a 20-percent risk weight to similar GSE and OECD depository institution exposures.

[39]The other Federal financial regulatory agencies stated in Basel IA that they were exploring options to permit certain small business loans to qualify for a 75-percent risk weight.

[40]We present a comparable threshold in terms of U.S. dollars. The standardized approach of Basel II has a threshold of €1 million.

[41]Qualified residential loans are rural home loans (as defined by 12 CFR 613.3030) and single-family residential loans to bona fide farmers, ranchers, or producers or harvesters of aquatic products that meet

the requirements listed in 12 CFR 615.5201.

[42]This section was not in the previous ANPRM.

[43]A CCF is a number by which an off-balance sheet item is multiplied to obtain a credit equivalent before placing the item in a risk-weight category.

[44]Our existing regulations assign a 0-percent CCF to unused commitments with an original maturity of 14 months or less. Unused commitments with an original maturity of greater than 14 months can also receive a 0-percent CCF provided the commitment is unconditionally cancelable and the System institution has the contractual right to make a separate credit decision before each drawing under the lending arrangement. All other unused commitments with an original maturity of greater than 14 months are assigned a 50-percent CCF.

[45]An unconditionally cancelable commitment is one that can be canceled for any reason at any time without prior notice.

[46]Basel IA proposed to retain the 0-percent CCF for all unconditionally cancelable commitments, apply a 10-percent CCF to all other short-term commitments, and retain the 50-percent CCF for all long-term commitments.

[47]Each business line is multiplied by a fixed percentage and then summed together to determine the annual gross income. The eight lines of business are corporate finance (18 percent), trading and sales (18 percent), retail banking (12 percent), commercial banking (15 percent), payment and settlement (18 percent), agency services (15 percent), asset management (12 percent), and retail brokerage (12 percent).

[48]This section was not in the previous ANPRM.

[49]Disclosure is a qualifying criterion under Pillar I to obtain lower risk weightings and/or to apply specific methodologies.

[50]Pillar III of Basel II provides minimum disclosure requirements on capital structure and adequacy, and risk exposure and assessment on credit risk, market risk, operational risk, equities, and interest rate risk in the banking book.

[51]Disclosure of key capital ratios should be made on a quarterly basis. Qualitative disclosures providing a general summary of a bank's risk management objective and policies, reporting system and definitions may be published on an annual basis.

[52]U.S. Basel II banks are encouraged to provide this information in one place on the entity's public Web site.

[53]These disclosures would be tested by external auditors as part of the financial statement audit.

[54]The net collateral ratio is a bank's net collateral as defined in 12 CFR 615.5301(c) divided by the bank's adjusted total liabilities.

[55]<u>See</u> 12 CFR 615.5335(a).

[56]See 12 CFR 3.6(b) and (c); 12 CFR part 208, appendix B and 12 CFR part 225, appendix D; 12 CFR 325.3; and 12 CFR 567.8.

[57]12 CFR part 615, subpart M.

[58]A capital directive is defined in § 615.5355(a) as an order issued to an institution that does not have or maintain capital at or greater than the minimum ratios set forth in 12 CFR 615.5205, 615.5330, and 615.5335, or established under subpart L of part 615, or by a written agreement under an enforcement or supervisory action, or as a condition of approval of an application. The FCA's authority is set forth in sections 4.3(b)(2) and 4.3A(e) of the Farm Credit Act (12 U.S.C. 2154(b)(2) and 2154a(e)).

[59]See 12 U.S.C. 1831o for the prompt corrective action provisions that apply to commercial banks and savings associations.

[60]This section was not in the previous ANPRM.

73 FR 15955, 03/26/2008

Handbook Mailing HM-08-1

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052-AC25

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Capital Adequacy--Basel Accord

AGENCY: Farm Credit Administration.

ACTION: Advance notice of proposed rulemaking (ANPRM); extension of comment period.

SUMMARY: The Farm Credit Administration (FCA, Agency or we) is extending the comment period on our ANPRM that seeks comments to facilitate the development of enhancements to our regulatory capital framework to more closely align minimum capital requirements with risks taken by Farm Credit System (FCS or System) institutions. We are extending the comment period so all interested parties will have additional time to provide comments.

DATES: You may send comments on or before December 31, 2008.

ADDRESSES: We offer several methods for the public to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. Regardless of the method you use, please do not submit your comments multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- Agency Web site: http://www.fca.gov. Select "Legal Info," then "Pending Regulations and Notices."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed, as faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or on our Web site at http://www.fca.gov. Once you are in the Web site, select "Legal Info," and then select "Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Laurie Rea, Associate Director, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4232, TTY (703) 883-4434,

or

Wade Wynn, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4262, TTY (703) 883-4434,

or

Rebecca S. Orlich, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION: On October 31, 2007, FCA published a notice in the Federal Register seeking public comment to facilitate the development of a proposed rule that would enhance our regulatory capital framework and more closely align minimum capital requirements with risks taken by System institutions. See 72 FR 61568. The comment period is scheduled to expire on March 31, 2008. In a letter dated March 4, 2008, the Federal Farm Credit Banks Funding Corporation, on behalf of the System banks and associations, requested that the Agency extend the comment period until December 31, 2008. In view of the number and the complexity of the questions asked in the ANPRM, we have granted this request. The FCA supports public involvement and participation in its regulatory process and invites all interested parties to review and provide comments on our ANPRM.

Dated: March 21, 2008

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

73 FR 15259, 03/21/2008

Handbook Mailing HM-08-2

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket ID OCC-2008-0002]

FEDERAL RESERVE SYSTEM

[Docket No. OP-1311]

FEDERAL DEPOSIT INSURANCE CORPORATION

RIN 3064-ZA00

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

[Docket ID OTS-2008-0001]

FARM CREDIT ADMINISTRATION

RIN 3052-AC46

NATIONAL CREDIT UNION ADMINISTRATION

RIN 3133-AD41

Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); Farm Credit Administration (FCA); National Credit Union Administration (NCUA).

ACTION: Notice and request for comment.

SUMMARY: The OCC, Board, FDIC, OTS, FCA, and NCUA (collectively, the Agencies) are soliciting comment on proposed revisions to the Interagency Questions and Answers Regarding Flood Insurance (Interagency Questions and Answers).

To help financial institutions meet their responsibilities under Federal flood insurance legislation and to increase public understanding of their flood insurance regulations, the staffs of the Agencies have prepared proposed new and revised guidance addressing the most frequently asked questions and answers about flood insurance. The proposed revised Interagency Questions and Answers contain staff guidance for agency personnel, financial institutions, and the public.

DATE: Comments must be submitted on or before May 20, 2008.

ADDRESSES:

OCC:

Because paper mail in the Washington, DC area and at the Agencies is subject to delay, commenters are encouraged to submit comments by e-mail, if possible. Please use the title ``Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers
Regarding Flood Insurance'' to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- *E-mail:* regs.comments@occ.treas.gov.
- *Mail:* Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 1-5, Washington, DC 20219.
- *Fax:* (202) 874-4448.
- *Hand Delivery/Courier:* 250 E Street, SW., Attn: Public Information Room, Mail Stop 1-5, Washington, DC 20219.

Instructions: You must include ``OCC'' as the agency name and ``Docket ID OCC-2008-0002'' in your comment. Comments received,
including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any
information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice by any of the following methods:

- *Viewing Comments Personally:* You may personally inspect and photocopy comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-5043. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.
- *Docket:* You may also view or request available background documents and project summaries using the methods described above.

Board:

You may submit comments, identified by Docket No. OP-1311, by any of the following methods:

- *Agency Web Site:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.federalreserve.gov. Follow the instructions for submitting comments at http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://

www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- *Federal eRulemaking Portal:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.regulations.gov. Follow the instructions for submitting comments.
- *E-mail:* regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- *Fax:* (202) 452-3819 or (202) 452-3102.
- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue,
NW., Washington, DC 20551.

All public comments are available from the Board's Web site at http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information.

Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.)
between 9 a.m. and 5 p.m. on weekdays.

FDIC:

You may submit comments, identified by RIN number 3064-ZA00 by any of the following methods:

- *Agency Web site:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.fdic.gov/regulations/laws/federal/propose.html. Follow instructions for submitting comments on the Agency Web Site.
- *E-mail:* Comments@FDIC.gov. Include the RIN number in the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW.,
Washington, DC 20429.
- *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between
- 7 a.m. and 5 p.m.

Instructions: All submissions received must include the agency name and RIN number. All comments received will be posted without change to http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.fdic.gov/regulations/laws/federal/propose.html including any personal information provided.

OTS:

You may submit comments, identified by OTS-2007-0001, by any of the following methods:

- *E-mail:* regs.comments@ots.treas.gov. Please include ID OTS-2008-0001 in the subject line of the message and include your name and telephone number in the message.
- *Fax:* (202) 906-6518.
- *Mail:* Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552,

- Attention: OTS-2008-0001.
- *Hand Delivery/Courier:* Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention:
  Regulation [[**Page** 15260]] Comments, Chief Counsel's Office, Attention: OTS-2008-0001.

Instructions: All submissions received must include the agency name and docket number for this rulemaking. All comments received will be entered into the docket and posted on Regulations.gov without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

- *Viewing Comments Electronically:* OTS will post comments on the OTS Internet Site at http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1.
- *Viewing Comments On-Site* : You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an
  appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FCA:

We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, we encourage commenters to submit
comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. You may also send comments by mail or by facsimile
transmission. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit
comments by any of the following methods:

- *E-mail:* Send us an e-mail at regcomm@fca.gov.
- *Agency Web Site:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.fca.gov. Once you are at the Web site, select ``Legal Info,'' then ``Pending Regulations and Notices.''
- *Federal eRulemaking Portal:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.regulations.gov. Follow the instructions for submitting comments.
- *Mail:* Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive,
- McLean, VA 22102-5090.
- *Fax:* (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at
http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://ww

w.fca.gov. Once you are in the Web site, select ``Legal Info,'' and then select ``Public Comments.'' We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

NCUA:

You may submit comments by any of the following methods (Please send comments by one method only):

- *Federal eRulemaking Portal:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.regulations.gov. Follow the instructions for submitting comments,
- *NCUA Web Site:* http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.ncua.gov/RegulationsOpinionsLaws/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.
- *E-mail* : Address to regcomments@ncua.gov. Include ``[Your name] Comments on Flood Insurance, Interagency Questions & Answers'' in the e-mail subject line.
- *Fax:* (703) 518-6319. Use the subject line described above for e-mail.
- *Mail:* Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- *Hand Delivery/Courier:* Same as mail address.

Public Inspection: All public comments are available on the agency's Web site at http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.ncua.gov/RegulationsOpinionsLaws/comments as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT:

OCC: Pamela Mount, National Bank Examiner, Compliance Policy, (202) 874-4428; or Margaret Hesse, Special Counsel, Community and Consumer Law Division, (202) 874-5750, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Vivian Wong, Senior Attorney, Division of Consumer and Community Affairs, (202) 452-2412; Anjanette Kichline, Senior Supervisory Consumer Financial Services Analyst, (202) 785-6054; or Brad Fleetwood, Senior Counsel, Legal Division, (202) 452-3721, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. For the deaf, hard of hearing, and speech impaired only, teletypewriter (TTY), (202) 263-4869.

FDIC: Mira N. Marshall, Senior Policy Analyst (Compliance), Division of Supervision and Consumer Protection, (202) 898-3912; or Mark Mellon, Counsel, Legal Division, (202) 898-3884, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429. For the hearing impaired only, telecommunications device for the deaf (TDD): 800-925-4618.

OTS: Ekita Mitchell, Consumer Regulations Analyst, (202) 906-6451; Glenn Gimble, Senior Project Manager, (202) 906-7158; or Richard S. Bennett, Senior Compliance Counsel, (202) 906-7409, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

FCA: Mark L. Johansen, Senior Policy Analyst, Office of Regulatory Policy, (703) 993-4498; or Mary Alice Donner, Attorney Advisor, Office of General Counsel, (703) 883-4033, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090. For the hearing impaired only, TDD: (703) 883-4444.

NCUA: Moisette I. Green, Staff Attorney, Office of General Counsel, (703) 518-6540, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

SUPPLEMENTARY INFORMATION:

Background

The National Flood Insurance Reform Act of 1994 (the Reform Act) (Title V of the Riegle Community Development and Regulatory Improvement Act of 1994) comprehensively revised the two federal flood insurance statutes, the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973. The Reform Act required the OCC, Board, FDIC, OTS, and NCUA to revise their flood insurance regulations and required the FCA to promulgate flood insurance regulations for the first time. The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, ``the Agencies'') fulfilled these requirements by issuing a joint final rule in the summer of 1996. See 61 FR 45684 (August 29, 1996).

In connection with the 1996 joint rulemaking process, the Agencies received a number of requests to clarify specific issues covering a wide spectrum of the proposed rule's provisions. Many of these requests were addressed in the preamble to the joint final rule. The Agencies concluded, however, that given the number, level of detail, and diversity of subject matter of [[**Page** 15261]] the requests for additional information, guidance addressing the more technical compliance issues would be helpful and appropriate. Consequently, the Agencies decided to issue guidance to address these technical issues subsequent to the promulgation of the final rule (61 FR at 45685-86). That objective was fulfilled by the initial release of the Interagency Questions and Answers in 1997 (1997 Interagency Questions and Answers) by the Federal Financial Institution Examination Council (FFIEC). 62 FR 39523 (July 23, 1997).

In response to issues that have been brought to the attention of the Agencies in coordination with the Federal Emergency Management Agency (FEMA), the Agencies are releasing for public comment proposed revisions to the 1997 Interagency Questions and Answers.\1\ Among the changes the Agencies are proposing are the introduction of new questions and answers in a number of areas, including second lien mortgages, the imposition of civil money penalties, and loan syndications/participations. The Agencies are also proposing substantive modifications to questions and answers previously adopted in the 1997 Interagency Questions and Answers pertaining to construction loans and condominiums. Finally, the Agencies are proposing to revise and reorganize certain of the existing questions and answers to clarify areas of potential misunderstanding and to

provide clearer guidance to users. It is the intention of the Agencies that after public comment has been received and considered, and the
Interagency Questions and Answers have been adopted in final form, they will supersede the 1997 Interagency Questions and Answers and
supplement other guidance or interpretations issued by the Agencies and FEMA.

\1\ The proposed Interagency Questions and Answers have been prepared by staff from the OCC, Board, FDIC, OTS, NCUA and FCA in
consultation with and with the assistance of the FFIEC pursuant to 12 U.S.C. 3305(g).

For ease of reference, the following terms are used throughout this document: ``Act'' refers to 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 (codified at 42 U.S.C. 4001 et seq.). ``Regulation'' refers to each agency's current final rule.\2\

\2\ The Agencies' rules are codified at 2 CFR part 22 (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (FDIC), 12 CFR part 572 (OTS),
12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA).

Section-by-Section Analysis

Section I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance Is Required Under the Act and Regulation

The Agencies propose to eliminate current section I entitled ``Definitions'' and replace it with new proposed section I to address more specific circumstances a lender may encounter when deciding whether a loan should be a designated loan for purposes of flood insurance. The Agencies are proposing to move the questions and answers currently in section I into subsequent sections for better organization. Meanwhile, questions and answers currently in other sections of the 1997 Interagency Questions and Answers that deal with determining when a loan is a designated loan under the Act and Regulation would be included in new section I.

Specifically, proposed question 1, which covers the applicability of the Regulation to a loan in a nonparticipating community, would be moved from current question 1 of section II. Further, the Agencies propose to move current question 2 of section II, discussing whether a loan is a designated loan when a lender purchases a whole loan, to question 3 of new section I. Current question 9 of section I, discussing whether a loan is a designated loan when a lender restructures a loan, would be moved to question 4 of this new section I, and proposed question 5, which addresses table funded loans, would be moved from question 3 of current section II. In addition, minor nonsubstantive changes have been made to these moved questions and answers to provide additional clarity.

The Agencies are also proposing to add two new questions and answers to this section in response to questions the Agencies have received from lenders. Proposed new question 2 explains that, upon a FEMA map change that results in a building or mobile home securing a loan being removed from a special flood hazard area (SFHA), the lender no longer must require mandatory flood insurance; however, the lender may choose to continue to require flood insurance for risk management purposes.

Proposed new question 6 explains that portfolio reviews of existing loans are not required by the Act or Regulation; however, sound risk management practices may lead a lender to conduct periodic reviews. These two new questions and answers are based on current guidance the Agencies have provided to lenders.

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

Proposed section II would provide guidance on how lenders should determine the appropriate amount of flood insurance to require the borrower to purchase. The Agencies are proposing to retain existing questions 5 and 7 of section II in new section II and renumbering them as proposed questions 12 and 11, respectively. Although minor changes have been made to these two questions and answers for purposes of clarity, the changes are not substantive. Furthermore, part of the guidance currently provided in existing question 7 would be moved to proposed question 22 in section V, as discussed below.

Proposed new question 7 would discuss what is meant by the ``maximum limit of coverage available for the particular type of property under the Act.'' This concept is important because the Regulation states that the amount of flood insurance required ``must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act.'' Proposed question 7 would introduce and define the insurance term, ``insurable value,'' as it relates to the determination of the maximum limit of coverage available under the Act. Proposed question 7 would also introduce the terms, ``residential building'' and ``nonresidential building.'' These terms would be more fully defined in proposed new questions 8 and 9 of this section, respectively.

Proposed new question 10 would discuss how much flood insurance is required on a building located in an SFHA in a participating community. It would also provide an example showing how to calculate the amount of required flood insurance on a nonresidential building.

Proposed new question 13 would clarify that a lender can require more flood insurance than the minimum required by the Regulation. The Regulation requires a minimum amount of flood insurance; however, lenders may require more coverage, if appropriate.

Proposed new question 14 would address lender considerations regarding the amount of the deductible on a flood insurance policy purchased by a borrower. Generally, the guidance advises a lender to determine the reasonableness of the deductible on a case-by-case basis, taking into account [[**Page** 15262]] the risk that such a deductible would pose to the borrower and lender.

Section III. Exemptions from the mandatory flood insurance requirements

As with current section III, proposed section III would contain only one question and answer, which describes the statutory exemptions from the mandatory flood insurance requirements. Proposed question and answer 15 under section III would be revised to provide greater clarity, with no intended change in substance or meaning.

Section IV. Flood insurance requirements for construction loans

The Agencies are proposing a series of new and revised questions and answers to clarify the requirements regarding the mandatory purchase of flood insurance for construction loans to erect buildings that will be located in an SFHA. The Agencies believe that these questions and answers are necessary in light of recent concerns raised by some regulated lenders regarding borrowers' difficulties in obtaining flood insurance for construction loans at the time of loan origination.

Existing question 2 in section I would be revised to provide greater clarity and would be moved to proposed question 16 under proposed section IV. The proposed answer to question 16 would revise the existing guidance to limit its scope and explain that a loan secured by raw land located in an SFHA is not a designated loan that would require flood insurance coverage. The remaining guidance currently in the answer to existing question 2 in section I would be discussed in subsequent questions and answers in section IV in the proposed document, as detailed below.

Proposed question 17, derived from current question 1 in section I, would address whether a loan secured or to be secured by a building in the course of construction that is located or to be located in an SFHA in which flood insurance is available under the Act is a designated loan. The answer would provide that a lender must make a flood determination prior to loan origination for a construction loan. If the flood determination shows that the building securing the loan will be located in an SFHA, the lender must provide notice to the borrower, and must comply with the mandatory purchase requirements. Proposed question 18 would explain that, generally, a building in the course of construction is eligible for coverage under a National Flood Insurance Program (NFIP) policy, and that coverage may be purchased prior to the start of construction.

Proposed question 19 would address the timing of when flood insurance must be purchased for buildings under the course of construction. The Act and Regulation provide that lenders may not make, increase, extend, or renew any loan secured by improved real estate or a mobile home that is located or to be located in an SFHA unless the building is covered by adequate flood insurance. One way for lenders to comply with the mandatory purchase requirement for a loan secured by a building in the course of construction that is located in an SFHA is to require borrowers to have a flood insurance policy in place at the time of loan origination.

Recently, lenders have informed agency staff, however, that borrowers have been encountering difficulties in obtaining flood insurance for construction loans at the time of loan origination due to insurers' refusals to write policies on undeveloped land until either an elevation certificate has been issued for the structure or at least two walls and a roof for the building have been erected. The Agencies have also received reports that borrowers who are able to obtain flood insurance for construction loans at loan origination often pay the highest premiums possible because elevations for the insured property have not yet been established.

To address these concerns, the Agencies, in the answer to proposed question 19, would provide lenders with flexibility regarding the timing of the mandatory purchase requirement for construction loans by permitting lenders to allow borrowers to defer the purchase of flood insurance until a foundation slab has been poured and/or an elevation certificate has been issued. Lenders, however, must require the borrower to have flood insurance in place before funds are disbursed to pay for building construction on the property securing the loan (except as necessary to pour the slab or perform preliminary site work). A lender who elects this approach and does not require flood insurance at loan origination must have adequate internal controls in place to ensure compliance.

The Agencies also propose to add new question 20 to clarify whether the 30-day waiting period for an NFIP policy applies when the purchase
of flood insurance is deferred in connection with a construction loan since there has been confusion among lenders on this issue in the past.
Per guidance from FEMA, the answer would provide that the 30-day waiting period would not apply in such cases.\3\ The NFIP would rely on
the insurance agent's representation that the exception applies unless a loss has occurred during the first 30 days of the policy period.

\3\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, (September 2007) at 30. FEMA has made available a new version of
this booklet electronically at
http://frwebgate.access.gpo.gov/cgi-bin/leaving.cgi?from=leavingFR.html&log=linklog&to=http://www.fema.gov/library/viewRecord.do?id=2954. Hard copies are available by calling FEMA's Publication Warehouse at (800) 480-2520.

Section V. Flood insurance requirements for agricultural buildings

The Agencies are proposing a new section V to address the flood insurance requirements for agricultural buildings that are taken as security for a loan, but that have limited utility to a farming operation. The section would also address loans secured by multiple buildings where some buildings are located in a flood hazard area and some buildings are not.

The proposed answer to new question 21 would explain that all buildings taken as security for a loan and located in an SFHA require flood insurance. Lenders have the option of carving a building from the security for a loan; however, the Agencies believe that it is typically
inappropriate for credit risk management reasons to do so.

The guidance in current question 7 under section II would be split between question 11 under proposed section II, as discussed above, and
question 22 under proposed section V. The proposed answer to question 22 would explain that a lender is always required to determine whether
a building securing a loan is located in an SFHA, but that only those buildings located in an SFHA and within a participating community are
required to have flood insurance. Flood insurance need not be required on those properties that (1) are not located in a special flood hazard
area (whether or not within a participating community) or (2) are located in a special flood hazard area that is not within a participating community.

Section VI. Flood insurance requirements for residential condominiums

For organizational purposes, the Agencies are proposing to consolidate questions and answers relating to the Regulation's flood insurance requirements for residential condominiums into a new section VI. In addition to modifying and expanding the two existing questions in the 1997 Interagency Questions and Answers on residential condominiums, the Agencies are proposing to add five additional [[**Page** 15263]] questions and answers to provide better clarity on the requirements.

Proposed question and answer 24 would modify and expand current question 8 under section II to more completely address the Regulation's flood insurance requirements for residential condominium units. The proposed answer would first explain that the amount of flood insurance coverage on the condominium unit required by the Regulation is the lesser of the outstanding principal balance of the loan or the maximum amount of coverage available under the NFIP.

The proposed answer would then explain that if the outstanding principal balance of the loan is greater than the maximum amount of coverage available under the NFIP, the lender must require a borrower whose loan is secured by a residential condominium unit to either:

- Ensure the condominium owners association has purchased an NFIP Residential Condominium Building Association Policy (RCBAP) covering either 100 percent of the insurable value (replacement cost) of the building, including amounts to repair or replace the foundation and its supporting structures, or an amount equal to the total number of units in the condominium building times $250,000, whichever is less; or

- Obtain an individual unit owner's dwelling policy in an amount sufficient to meet the Regulation's flood insurance requirements, if there is no RCBAP or the RCBAP coverage is less than either 100 percent of the insurable value (replacement cost) of the building or the amount equal to the total number of units in the condominium building times $250,000, whichever is less.

The proposed answer revises and clarifies the current answer to question 8 under section II. The current answer provides that ``to meet federal flood insurance requirements, an RCBAP should be purchased in an amount of at least 80 percent of the replacement value of the building or the maximum amount available under the NFIP (currently $250,000 multiplied by the number of units), whichever is less."

The proposed question and answer recognizes that neither the Act nor the Regulation addresses explicitly the appropriate level of RCBAP coverage; rather, they address the general purchase requirement applicable to all types of buildings and mobile homes: The lesser of the outstanding principal balance of the loan or the maximum amount of insurance available under the NFIP. The proposed question and answer acknowledges the standard set forth in the Regulation, and clarifies that the maximum amount of insurance available under the NFIP for a residential condominium unit is the lesser of the maximum limit available for a residential condominium unit (currently, $250,000) or the insurable value of the unit (the replacement value of the building divided by the number of units).\4\ The proposed question and answer would also reflect that where the outstanding principal balance of the loan is greater than the maximum amount of coverage available under the NFIP, an RCBAP written at 80 percent of the replacement cost value of the building does not meet the Regulation's flood insurance requirements (unless that amount were equal to the maximum amount of insurance available under the NFIP, which is $250,000 multiplied by the number of units), whereas the current answer suggested that such a coverage level was adequate. While

FEMA's recent guidance prescribes 80 percent replacement cost value coverage as the minimum amount necessary to avoid imposition of a co-insurance penalty at the time of loss,\5\ proposed answer 24 clarifies that this amount of insurance is insufficient to comply with the Act's and Regulation's minimum requirements. The proposed answer would provide that where the outstanding principal balance of the loan is greater than the maximum amount of coverage available under the NFIP and the RCBAP is written at less than 100 percent of the insurable value (replacement cost) of the building or an amount equal to $250,000 multiplied by the number of units, whichever is less, the lender must require the borrower to obtain an individual unit owner's dwelling policy to meet the Regulation's flood insurance requirements.

\4\ In recent guidance, FEMA expressly discusses the statutory standard for determining the required amount of flood insurance for a condominium. FEMA Mandatory Purchase of Flood Insurance Guidelines, at 46.

\5\ FEMA's recent guidance encourages condominium associations to obtain 100 percent coverage. Id. at 47.

The Agencies are proposing the modification contained in proposed question 24 and its answer to be in accordance with the general mandatory purchase requirement in the Regulation. As FEMA has noted:

> Although unit owners have a shared interest in the common areas of the condominium building, as well as in their own unit, unit owners are unable to individually protect such common areas. Therefore, the RCBAP, insured to its full replacement cost value (RCV) to the extent possible under the NFIP, is the correct way to insure a residential condominium building against flood loss. A properly placed RCBAP protects the financial interests of the association, unit owners, and lenders and also satisfies the statutory requirements.\6\

\6\ See id. at 46.

The Agencies plan that any guidance adopted as final in question and answer 24 would apply to any loan that is made, increased, extended, or renewed after the effective date of the revised guidance. The Agencies further plan that the revised guidance would apply to any loan made prior to the effective date of the revised guidance, which a lender determines to be covered by flood insurance in an amount less than required by the Regulation, as set forth in proposed question and answer 24, at the first flood insurance policy renewal period following the effective date of the revised guidance.

Proposed question 27 would modify and expand current question 9 under section II to address lenders' options when a loan secured by a residential condominium unit is in a multi-unit complex whose condominium association allows its existing flood insurance policy to lapse. Specifically, if the borrower/unit owner or the condominium association fails to purchase adequate flood insurance within 45 days of the lender's notification of inadequate insurance coverage, the lender must force place flood insurance to cover the unit owner's dwelling in an amount adequate to meet the Regulation's flood insurance requirements.

The Agencies are also proposing five new questions and answers to address additional issues regarding flood insurance requirements for residential condominiums. Proposed new question 23 would be added to specifically affirm that the mandatory flood insurance purchase requirements under the Act and Regulation apply to loans secured by individual residential condominium units, including those in multi-story condominium complexes located in an SFHA in which flood insurance is available under the Act.

Proposed new question 25 would address lenders' options when a loan secured by a residential condominium unit is in a multi-unit complex whose condominium association does not obtain or maintain the amount of flood insurance coverage required under the Regulation. Specifically, it would provide that a lender must require the borrower to purchase an individual unit owner's dwelling policy in an amount sufficient to meet the Regulation's flood insurance requirements. The proposed answer would also detail what is considered an adequate amount of flood insurance under the Regulation and provide an example.

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Proposed new question 26 would address the steps a lender must take if the RCBAP coverage is insufficient to meet the Regulation's mandatory purchase requirements for a loan secured by an individual residential condominium unit. The proposed answer would also summarize some of the risks to which the lender and the individual unit owner/borrower may be exposed should a loss occur where the condominium association did not maintain adequate flood insurance coverage under an RCBAP.

Proposed new question 28 would be added to explain how the RCBAP's co-insurance penalty applies when, at the time of loss, the RCBAP's coverage amount is less than 80 percent of either the building's replacement cost or the maximum amount of flood insurance available for that building under the NFIP (whichever is less). Examples of how to calculate the penalty would also be provided. Proposed new question 29 would be added to explain the interplay between the individual unit owner's dwelling policy coverage limitations and the RCBAP.

Section VII. Flood insurance requirements for home equity loans, lines of credit, subordinate liens, and other security interests in collateral located in an SFHA

Proposed new Section VII, which addresses flood insurance requirements for home equity loans, lines of credit, subordinate liens, and other security interests in collateral located in an SFHA, would include seven questions from current section I and parts of two questions from current section V. Specifically, current questions 3, 4, 5, 6, 7, 8, and 10 would be renumbered as questions 30, 31, 34, 35 and 36, 37, 38, and 39 respectively. Current question 5 in section V would be split into proposed questions 32 and

33.

Proposed questions and answers 30, 31, and 39 would include minor wording changes without any intended change in substance or meaning.
Proposed question 32 would expand on part of current section V, question 5, but would not change the substance of the answer. New
question 34 would be revised to clarify the issue discussed in current question 5 of section I without any change in substance or meaning. New
questions 35 and 36 would be added to clarify the issues discussed in current question 6 of section I.

Section VIII. Flood insurance requirements for loan syndications/participations

The Agencies are proposing to include a new section VIII and new question 40 in response to questions from lenders. The proposed question and answer would explain that, with respect to loan syndications and participations, individual participating lenders are responsible for ensuring compliance with flood insurance requirements. The Agencies believe that the risk of flood loss can be a significant threat to the value of improved real property securing loans, especially in light of many recent catastrophic flood-related events such as Hurricane Katrina. Therefore, the Agencies believe that each lender in a loan participation/syndication arrangement that is secured by improved real property located in a special flood hazard area should be responsible for ensuring that the respective interest of the lender in the collateral that secures the lender's portion of the loan is protected against the risk of flood loss, at least to the amount required by the Regulation. This does not mean that each lender in a syndication or participant in a loan must individually undertake such activities as obtaining a flood determination or monitoring whether flood insurance premiums are paid. Rather, it means that the participating lender should perform 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. The participating lender should require as a condition to the participation, syndication or other credit risk sharing agreement that the lead lender or agent will provide
participating lenders with sufficient information on an ongoing basis to monitor compliance with flood insurance requirements.

Section IX. Flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights

The heading to proposed section IX has been modified to provide greater clarity with no intended change in substance or meaning. The
current questions 1, 2, 3, 4, 5, and 6 under current section IX would be renumbered as proposed questions 42, 43, 44, 45, 46, and 47,
respectively, with minor revisions to questions and answers 42 and 46 to provide greater clarity, with no intended change in substance or
meaning. Proposed section IX would also incorporate and expand current question 6 under section II as proposed question and answer 41.
Proposed question 41 would expound on the two scenarios from current question 6 to provide greater clarity, with no intended change in
substance or meaning.

Section X. Escrow requirements

Current section IV on escrow requirements would be moved to proposed section X but would remain largely unchanged. Question 1 under current section IV, relating to the date loan originations were subject to the escrow requirement, would be deleted, as it is now obsolete.
Questions 2 through 7 under current section IV would be renumbered as proposed questions 48 through 53, respectively, with minor changes for greater clarity with no intended change in substance or meaning.

Section XI. Forced placement of flood insurance

For organizational purposes, the Agencies are proposing to move existing questions 1, 2, and 3 in Part VI to questions 54, 55, and 56 in section XI of the proposed document, respectively. The Agencies are proposing minor revisions to proposed question and answer 54 to provide greater clarity, with no intended change in substance or meaning.

Section XII. Gap insurance policies

The Agencies are proposing to add a new section and question and answer on the appropriateness of gap or blanket insurance policies, often purchased by lenders to ensure adequate life-of-loan flood insurance coverage for designated loans, as a result of questions received by the Agencies on such policies. Gap or blanket insurance policies are lender-paid private policies that are meant to cover a lender's entire portfolio of loans for insurance shortfalls or expired policies.

The proposed answer to question 57 of section XII would explain that, generally, gap or blanket insurance is not an adequate substitute for NFIP insurance, as a gap or blanket policy typically protects only the lender's, not the borrower's interest, and cannot be transferred when a loan is sold. The question and answer would acknowledge, however, that in limited circumstances, a gap or blanket policy may satisfy flood insurance obligations in instances where NFIP and private insurance for the borrower are otherwise unavailable.

Section XIII: Required use of the Standard Flood Hazard Determination Form (SFHDF)

Current section V would be moved to proposed section XIII, and questions 1, [[**Page** 15265]] 2, 3, and 4 of current section V would be renumbered as proposed questions 58, 59, 60, and 61, respectively. The Agencies are proposing some minor changes to the answers for these questions to provide additional clarity with no intended change in substance or meaning. For organizational purposes, the guidance found in question 5 of current section V would be moved to proposed questions 32 and 33 under proposed section VII, as discussed above.

Section XIV. Flood determination fees

Current section VII would be moved to proposed section XIV. Questions 1 and 2 in current section VII would be renumbered as questions 62 and 63, respectively, with only minor language modifications, with no intended change in substance or meaning.

Section XV. Flood zone discrepancies

The Agencies are proposing a new section and two new questions concerning issues where there is a discrepancy between the flood hazard zone designation on a flood hazard determination form and the flood hazard zone designation on the flood insurance policy. Proposed new question 64 would address how lenders should respond when confronted with a discrepancy between the flood hazard zone designations on the flood hazard determination form and the flood insurance policy. The question discusses the legitimate reasons why such discrepancies may exist and describes how to resolve differences if there is no legitimate reason for them. Proposed question 65 discusses when such flood zone discrepancies in a loan portfolio will result in a finding that the lender violated federal flood insurance requirements. If there are repeated instances in the lender's loan portfolio of discrepancies between the flood hazard zone listed on a flood hazard determination and the flood hazard zone listed on a flood insurance policy, and the lender has not taken steps to resolve such discrepancies, then an agency may find that the lender has violated the mandatory purchase requirements.

Section XVI. Notice of special flood hazards and availability of Federal disaster relief

The Agencies propose to move current section VIII to proposed section XVI. Therefore, questions 1, 2, 3, 4, 5, and 6 under current section VIII would be renumbered as proposed questions 66, 67, 68, 69, 70, and 71, respectively, with nonsubstantive changes made to provide additional clarity to the answers. For organizational purposes, question 1 under current section X would be consolidated under this new section XVI and renumbered as question 73. Furthermore, a new question 72 is proposed to be added to clarify that the Notice of Special Flood Hazards must be provided to the borrower each time a loan is made, increased, extended, or renewed, even when a new determination is not required.

Section XVII. Mandatory civil money penalties

The Agencies are proposing a new section and two new questions concerning the imposition of mandatory civil money penalties for violations of the flood insurance requirements. Proposed new question 74 would list the sections of the Act that trigger mandatory civil money penalties when examiners find a pattern or practice of violations of those sections. The question would also include information about statutory limits on the amount of such penalties. Proposed new question 75 would discuss the general standards the Agencies consider when determining whether violations constitute a pattern or practice for which civil money penalties are mandatory. These considerations are not dispositive of individual cases, but serve as a reference point for reviewing the particular facts and circumstances.

Redesignation Table

The following redesignation table is provided as an aide to assist the public in reviewing the proposed revisions to the 1997 Interagency Questions and Answers.

Current	Proposed
Section I. Definitions:	
Section I, Question 1.....	Section IV, Question 17.
Section I, Question 2.....	Section IV, Question 16.
Section I, Question 3.....	Section VII, Question 30.
Section I, Question 4.....	Section VII, Question 31.

Section I, Question 5..... Section VII, Question 34.
Section I, Question 6..... Section VII, Question 35; and Section VII, Question 36.
Section I, Question 7..... Section VII, Question 37.
Section I, Question 8..... Section VII, Question 38.
Section I, Question 9..... Section I, Question 4.
Section I, Question 10.... Section VII, Question 39.

Section II. Requirement to Purchase Flood Insurance Where Available:
Section II, Question 1.... Section I, Question 1.
Section II, Question 2.... Section I, Question 3.
Section II, Question 3.... Section I, Question 5.
Section II, Question 4.... Deleted as obsolete.
Section II, Question 5.... Section II, Question 12.
Section II, Question 6.... Section IX, Question 41.
Section II, Question 7.... Section II, Question 11; and Section V, Question 22.
Section II, Question 8.... Section VI, Question 24.
Section II, Question 9.... Section VI, Question 27.

Section III. Exemptions....... Section III. Exemptions from the mandatory flood insurance requirements.
Section III, Question 1... Section III, Question 15.

Section IV. Escrow Requirements. Section X. Escrow requirements.
Section IV, Question 1.... Deleted as obsolete.
Section IV, Question 2.... Section X, Question 48.
Section IV, Question 3.... Section X, Question 49.

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Section IV, Question 4.... Section X, Question 50.
Section IV, Question 5.... Section X, Question 51.
Section IV, Question 6.... Section X, Question 52.
Section IV, Question 7.... Section X, Question 53.

Section V. Required Use of Standard Flood Hazard Determination Form (SFHDF). Section XIII. Required use of Standard Flood Hazard Determination Form (SFHDF).
Section V, Question 1..... Section XIII, Question 58.
Section V, Question 2..... Section XIII, Question 59.
Section V, Question 3..... Section XIII, Question 60.
Section V, Question 4..... Section XIII, Question 61.
Section V, Question 5..... Section VII, Question 32; and Section VII, Question 33.

Section VI. Forced Placement of Flood Insurance. Section XI. Forced placement of flood insurance.
Section VI, Question 1.... Section XI, Question 54.
Section VI, Question 2.... Section XI, Question 55.
Section VI, Question 3.... Section XI, Question 56.

Section VII. Determination Section XIV. Flood determination fees.

Fees.	
Section VII, Question 1...	Section XIV, Question 62.
Section VII, Question 2...	Section XIV, Question 63.
Section VIII. Notice of Special Flood Hazards and Availability of Federal Disaster Relief.	Section XVI. Notice of special flood hazards and availability of Federal disaster relief.
Section VIII, Question 1..	Section XVI, Question 66.
Section VIII, Question 2..	Section XVI, Question 67.
Section VIII, Question 3..	Section XVI, Question 68.
Section VIII, Question 4..	Section XVI, Question 69.
Section VIII, Question 5..	Section XVI, Question 70.
Section VIII, Question 6..	Section XVI, Question 71.
Section IX. Notice of Servicer's Identity.	Section IX. Flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights.
Section IX, Question 1....	Section IX, Question 42.
Section IX, Question 2....	Section IX, Question 43.
Section IX, Question 3....	Section IX, Question 44.
Section IX, Question 4....	Section IX, Question 45.
Section IX, Question 5....	Section IX, Question 46.
Section IX, Question 6....	Section IX, Question 47.
Section X Appendix A to the Regulation-Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance.	Section XVI. Notice of special flood hazards and availability of Federal disaster relief.
Section X, Question 1.....	Section XVI, Question 73.

Public Comments

The Agencies invite public comment on the proposed new and revised Interagency Questions and Answers. If financial institutions, bank examiners, community groups, or other interested parties have unanswered questions or comments about the Agencies' flood insurance regulations, they should submit them to the Agencies. The Agencies will consider including these questions and answers in the final guidance.

Solicitation of Comments Regarding the Use of ``Plain Language''

Section 722 of the Gramm-Leach-Bliley Act of 1999, 12 U.S.C. 4809, requires the federal banking Agencies to use ``plain language'' in all proposed and final rules published after January 1, 2000. Although this proposed guidance is not a proposed rule, comments are nevertheless

invited on whether the proposed interagency questions and answers are stated clearly and effectively organized, and how the guidance might be
revised to make it easier to read.

The text of the proposed Interagency Questions and Answers follows:

Interagency Questions and Answers Regarding Flood Insurance

The Interagency Questions and Answers are organized by topic. Each topic addresses a major area of the revised flood insurance law and
regulations. For ease of reference, the following terms are used throughout this document: ``Act'' refers to 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 (codified at 42 U.S.C. 4001 et seq.). ``Regulation'' refers to each agency's current final rule.\7\ The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, ``the Agencies'') are providing answers to questions pertaining to the following topics:

\7\ The Agencies' rules are codified at 12 CFR part 22 (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (FDIC), 12 CFR part 572 (OTS),
12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA).

I. Determining when certain loans are designated loans for which flood insurance is required under the Act and Regulation.
II. Determining the appropriate amount of flood insurance required under the Act and Regulation.
III. Exemptions from the mandatory flood insurance requirements.
IV. Flood insurance requirements for construction loans.
V. Flood insurance requirements for agricultural buildings.
VI. Flood insurance requirements for [[**Page** 15267]] residential condominiums.
VII. Flood insurance requirements for home equity loans, lines of credit, subordinate liens, and other security interests in collateral located in an SFHA.
VIII. Flood insurance requirements for loan syndications/participations.
IX. Flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights.
X. Escrow requirements.
XI. Forced placement of flood insurance.
XII. Gap insurance policies.
XIII. Required use of Standard Flood Hazard Determination Form (SFHDF).
XIV. Flood determination fees.
XV. Flood zone discrepancies.
XVI. Notice of special flood hazards and availability of Federal disaster relief.
XVII. Mandatory civil money penalties.

I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance is Required Under the Act and Regulation

1. Does the Regulation apply to a loan where the building or mobile home securing such loan is located in a community that does not *participate in the National Flood Insurance Program (NFIP)?*

Answer: Yes. The Regulation does apply; however, a lender need not require borrowers to obtain flood insurance for a building or mobile home located in a community that does not participate in the NFIP, even if the building or mobile home securing the loan is located in a Special Flood Hazard Area (SFHA). Nonetheless, a lender, using the standard Special Flood Hazard Determination Form (SFHDF), must still determine whether the building or mobile home is located in an SFHA. If the building or mobile home is determined to be located in an SFHA, a lender is required to notify the borrower. In this case, a lender, generally, may make a conventional loan without requiring flood insurance, if it chooses to do so. However, a lender may not make a Government-guaranteed or insured loan, such as an SBA, VA, or FHA, loan secured by a building or mobile home located in an SFHA in a community that does not participate in the NFIP. See 42 U.S.C. 4106(a). Also, a lender is responsible for exercising sound risk management practices to ensure that it does not make a loan secured by a building or mobile home located in an SFHA where no flood insurance is available, if doing so would be an unacceptable risk.

2. What is a lender's responsibility if a particular building or mobile home that secures a loan, due to a map change, is no longer located within an SFHA?

Answer: The lender is no longer obligated to require mandatory flood insurance; however, the borrower can elect to convert the existing NFIP policy to a Preferred Risk Policy. For risk management purposes, the lender may, by contract, continue to require flood insurance coverage.

3. Does a lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, from another lender trigger any requirements under the Regulation?

Answer: No. A lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, alone, is not an event that triggers the Regulation's requirements, such as making a new flood determination or requiring a borrower to purchase flood insurance. Requirements under the Regulation, generally, are triggered when a lender makes, increases, extends, or renews a designated loan. A lender's purchase of a loan does not fall within any of those categories.

However, if a lender becomes aware at any point during the life of a designated loan that flood insurance is required, the lender must comply with the Regulation, including force placing insurance, if necessary. Depending upon the circumstances, safety and soundness considerations may sometimes necessitate such due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. If the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the Regulation.

4. Does the Regulation apply to loans that are being restructured because of the borrower's default on the original loan?

Answer: Yes, if the loan otherwise meets the definition of a designated loan and if the lender increases the amount of the loan, or extends or renews the terms of the original loan.

5. Are table funded loans treated as new loan originations?

Answer: Yes. Table funding, as defined under HUD's Real Estate Settlement Procedure Act (RESPA) rule, 24 CFR 3500.2, is a settlement at which a loan is funded by a contemporaneous advance of loan funds and the assignment of the loan to the person advancing the funds. A loan made through a table funding process is treated as though the party advancing the funds has originated the loan. The funding party is required to comply with the Regulation. The table funding lender can meet the administrative requirements of the Regulation by requiring the party processing and underwriting the application to perform those functions on its behalf.

6. Is a lender required to perform a review of its, or its servicer's, existing loan portfolio for compliance with the flood insurance requirements under the Act and Regulation?

Answer: No. Apart from the requirements mandated when a loan is made, increased, extended, or renewed, 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 know of the need for NFIP coverage. Regardless of the lack of such requirement in the Act and Regulation, however, sound risk management practices may lead a lender to conduct scheduled periodic reviews that track the need for flood insurance on a loan portfolio.

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

7. The Regulation states that the amount of flood insurance required ``must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act.'' What is meant by the ``maximum limit of coverage available for the particular type of property under the Act''?

Answer: ``The maximum limit of coverage available for the particular type of property under the Act'' depends on the value of the secured collateral. First, under the NFIP, there are maximum caps on the amount of insurance available. For single-family and two-to-four family dwellings and other residential buildings located in a participating community under the regular program, the maximum cap is $250,000. For nonresidential structures located in a participating community under the regular program, the maximum cap is $500,000. (In participating communities that are under the emergency program phase, the caps are $35,000 for single-family and two-to-four family dwellings and other residential structures, and $100,000 for nonresidential structures).

In addition to the maximum caps under the NFIP, the Regulation also provides that ``flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located,'' which is commonly referred to as the ``insurable value'' of a structure. The NFIP does not insure land; therefore, land values should not be

included in [[**Page** 15268]] the calculation. An NFIP policy will not cover an amount exceeding the ``insurable value'' of the structure. In determining coverage amounts for flood insurance, lenders often follow the same practice used to establish other hazard insurance coverage amounts. However, unlike the insurable valuation used to underwrite most other hazard insurance policies, the insurable value of improved real property for flood insurance purposes also includes the repair or replacement cost of the foundation and supporting structures. 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. (Please note, however, when taking a security interest in
improved real property where the value of the land, excluding the value of the improvements, is sufficient collateral for the debt, the lender must nonetheless require flood insurance to cover the value of the structure if it is located in a participating community's SFHA).

8. What are examples of residential buildings?

Answer: Residential buildings include one-to-four family dwellings; apartment or other residential buildings containing more than four dwelling units; condominiums and cooperatives in which at least 75 percent of the square footage is residential; hotels or motels where the normal occupancy of a guest is six months or more; and rooming houses that have more than four roomers. A residential building may have incidental non-residential use, such as an office or studio, as long as the total area of such incidental occupancy is limited to less than 25 percent of the square footage of the building.

9. What are examples of nonresidential buildings?

Answer: Nonresidential buildings include small business concerns, churches, schools, farm buildings (including grain bins and silos), pool houses, clubhouses, recreational buildings, mercantile structures, agricultural and industrial structures, warehouses, hotels and motels with normal room rentals for less than six months' duration, nursing homes, and mixed-use buildings with less than 75 percent residential square footage.

10. How much insurance is required on a building located in an SFHA in a participating community?

Answer: 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).

Example: (calculating insurance required on a non-residential building): Loan security includes one equipment shed located in an SFHA in a participating community under the regular program.

- Outstanding loan principal is $300,000
- Maximum amount of insurance available under the NFIP:
  - Maximum limit available for type of structure is $500,000 per building (non-residential building)
  - Insurable value of the equipment shed is $30,000

The minimum amount of insurance required by the Regulation for the equipment shed is $30,000.

11. Is flood insurance required for each building when the real estate security contains more than one building located in an SFHA in a participating community? If so, how much coverage is required?

Answer: Yes. The lender must determine the amount of insurance required on each building and add these individual amounts together.
The total amount of required flood insurance 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 structures or
  - the ``insurable value" of the structures (see Question 7).

The amount of total required flood insurance can be allocated among the secured buildings in varying amounts, but all buildings in an SFHA
must have some coverage.

Example: Lender makes a loan in the principal amount of $150,000 secured by five nonresidential buildings, only three of which are located in SFHAs within participating communities.

- Outstanding loan principal is $150,000
- Maximum amount of insurance available under the NFIP
  - Maximum limit available for the type of structure is $500,000 per building (non-residential buildings); or
  - Insurable value (for each non-residential building for which insurance is required, which is $100,000, or $300,000 total)

Amount of insurance required for the three buildings is $150,000. This amount of required flood insurance could be allocated among the
three buildings in varying amounts, so long as each is covered by flood insurance.

12. If the insurable value of a building or mobile home, located in an SFHA in which flood insurance is available under the Act, securing a designated loan is less than the outstanding principal balance of the loan, must a lender require the borrower to obtain flood insurance up to the balance of the loan?

Answer: No. The Regulation provides that the amount of flood insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for a particular type of property under the Act. The Regulation also provides that flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the building or mobile home is located. Since the NFIP policy does not cover land value, lenders should determine the amount of insurance necessary based on the insurable value of the improvements.

13. Can a lender require more flood insurance than the minimum required by the Regulation?

Answer: Yes. Lenders are permitted to require more flood insurance coverage than required by the Regulation. The borrower or lender may
have to seek such coverage outside the NFIP. 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. Lenders should avoid creating situations where a building is being ``over-insured".

14. Can a lender allow the borrower to use the maximum deductible to reduce the cost of flood insurance?

Answer: Yes. However, it is not a sound business practice for a lender to allow the borrower to use the maximum deductible amount in every situation. A lender should determine the reasonableness of the

deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and lender. A lender may not allow the borrower to use a deductible amount equal to the [[**Page** 15269]]
insurable value of the property to avoid the mandatory purchase requirement for flood insurance.

III. Exemptions From the Mandatory Flood Insurance Requirements

15. What are the exemptions from coverage?

Answer: There are only two exemptions from the purchase requirements. The first applies to state-owned property covered under a policy of self-insurance satisfactory to the Director of FEMA. The second applies if both the original principal balance of the loan is $5,000 or less, and the original repayment term is one year or less.

IV. Flood Insurance Requirements for Construction Loans

16. Is a loan secured by raw land that is located in an SFHA in which flood insurance is available under the Act and that will be developed into buildable lot(s) a designated loan that requires flood insurance?

Answer: No. A designated loan is defined as a loan secured by a building or mobile home that is located or to be located in an SFHA in which flood insurance is available under the Act. Any loan secured by only raw land that is located in an SFHA in which flood insurance is available is not a designated loan since it is not secured by a building or mobile home.

17. Is a loan secured or to be secured by a building in the course of construction that is located or to be located in an SFHA in which flood insurance is available under the Act a designated loan?

Answer: Yes. Therefore, a lender must always make a flood determination prior to loan origination to determine whether a building to be constructed that is security for the loan is located or will be located in an SFHA in which flood insurance is available under the Act. If so, then the loan is a designated loan and the lender must provide the requisite notice to the borrower prior to loan origination that mandatory flood insurance is required. The lender must then comply with the mandatory purchase requirement under the Act and Regulation.

18. Is a building in the course of construction that is located in an SFHA in which flood insurance is available under the Act eligible for coverage under an NFIP policy?

Answer: Yes. FEMA's Flood Insurance Manual, under general rules, states:

> 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 Flood Elevation (BFE).

> Materials or supplies intended for use in such construction, alteration, or repair are not insurable unless they are contained within an enclosed building on the premises or adjacent to the premises.

Flood Insurance Manual at p. GR 4 (October 2006). The definition section of the Flood Insurance Manual defines ``start of construction'' in the case of new construction as ``either the first placement of permanent construction of a building on site, such as the pouring of a slab or footing, the installation of piles, the construction of columns, or any work beyond the stage of excavation; or the placement of a manufactured (mobile) home on a foundation.'' Flood Insurance Manual at p. DEF 9. 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 or when materials or supplies intended for use in such construction, alteration, or repair are contained in an enclosed building on the premises or adjacent to the premises.

19. When must a lender require the purchase of flood insurance for a loan secured by a building in the course of construction that is located in an SFHA in which flood insurance is available?

Answer: Under the Act, as implemented by the Regulation, a lender may not make, increase, extend, or renew any loan secured by a building or a mobile home, located or to be located in an SFHA in which flood insurance is available, unless the property is covered by adequate flood insurance for the term of the loan. One way for lenders to comply with the mandatory purchase requirement for a loan secured by a building in the course of construction that is located in an SFHA is to require borrowers to have a flood insurance policy in place at the time of loan origination.

Alternatively, a lender may allow a borrower to defer the purchase of flood insurance until a foundation slab has been poured and/or an elevation certificate has been issued, provided that the lender requires the borrower to have flood insurance in place before the lender disburses funds to pay for building construction (except as necessary to pour the slab or perform preliminary site work, such as laying utilities, clearing brush, or the purchase and/or delivery of building materials) on the property securing the loan. If the lender elects this approach and does not require flood insurance to be obtained at loan origination, then it must have adequate internal controls in place at origination to ensure that the borrower obtains flood insurance no later than when the foundation slab has been poured and/or an elevation certificate has been issued.

20. Does the 30-day waiting period apply when the purchase of the flood insurance policy is deferred in connection with a construction loan?

Answer: No. The NFIP will rely on an insurance agent's representation on the application for flood insurance that the purchase of insurance has been properly deferred unless there is a loss during the first 30 days of the policy period. In that case, the NFIP will require documentation of the loan transaction, such as settlement papers, before adjusting the loss.

V. Flood Insurance Requirements for Agricultural Buildings

21. Some agricultural operations have buildings on their farms with limited utility to the farming *operation and, in many cases, the farmer would not replace such buildings if lost in a flood. Is a lender required to mandate flood insurance for such buildings?*

Answer: Yes. Under the Regulation, lenders must require flood insurance on real estate improvements when those improvements are part of the property securing the loan and are located in an SFHA in a participating community. The Act does not differentiate agricultural lending from other types of lending.

The lender may consider ``carving out'' buildings from the security it takes on the loan. However, the lender should fully analyze the risks of this option. In particular, a lender should consider whether it would be able to market the property securing its loan in the event of foreclosure. Additionally, the lender should consider any local zoning issues or other issues that would affect its collateral.

22. What are a lender's requirements under the Regulation for a loan secured by multiple agricultural buildings located throughout a large geographic area where some of the buildings are located in an SFHA in which flood insurance is available and other buildings are not? What if the buildings are located in several jurisdictions or counties where some of the communities participate in the NFIP, and others do not?

Answer: A lender is required to make a determination as to whether the property securing the loan is in an SFHA. If secured property is located in an SFHA, but not in a participating [[**Page** 15270]] community, no flood insurance is required, although a lender can require the purchase of flood insurance (from a private insurer) as a matter of safety and soundness. Conversely, where a secured property is located in a participating community but not in an SFHA, no insurance is required. A lender must provide appropriate notice and require the purchase of flood insurance for designated loans located in an SFHA in a participating community. Agricultural buildings that are part of the loan's security and are located in an SFHA in a participating community are required to have flood insurance.

VI. Flood Insurance Requirements for Residential Condominiums

23. Are residential condominiums, including multi-story condominium complexes, subject to the statutory and regulatory requirements for flood insurance?

Answer: Yes. The mandatory flood insurance purchase requirements under the Act and Regulation apply to loans secured by individual residential condominium units, including those located in multi-story condominium complexes, located in an SFHA in which flood insurance is available under the Act. The mandatory purchase requirements also apply to loans secured by other condominium property, such as loans to a developer for construction of the condominium or loans to a condominium association.

24. What is the amount of flood insurance coverage that a lender must require with respect to residential condominium units, including those located in multi-story condominium complexes, to comply with the mandatory purchase requirements under the Act and the Regulation?

Answer: To comply with the Regulation, the lender must ensure that the minimum amount of flood insurance covering the condominium unit 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 residential condominium unit or
  - The ``insurable value'' allocated to the residential condominium unit, which is the replacement cost value of the condominium building divided by the number of units.

Assuming that the outstanding principal balance of the loan is greater than the maximum amount of coverage available under the NFIP, the lender must require a borrower whose loan is secured by a residential condominium unit to either:

- Ensure the condominium owners association has purchased an NFIP Residential Condominium Building Association Policy (RCBAP) covering either 100 percent of the insurable value (replacement cost) of the building, including amounts to repair or replace the foundation and its supporting structures, or the total number of units in the condominium building times $250,000, whichever is less; or
- Obtain a dwelling policy if there is no RCBAP, as explained in Question 25, or if the RCBAP coverage is less than 100 percent of the replacement cost value of the building or the total number of units in the condominium building times $250,000, whichever is less, as explained in Question 26.

The RCBAP, which is a master policy for condominiums issued by FEMA, may only be purchased by the condominium owners association. The RCBAP covers both the common and individually owned building elements within the units, improvements within the units, and contents owned in common. The maximum amount of building coverage that can be purchased under an RCBAP is either 100 percent of the replacement cost value of the building, including amounts to repair or replace the foundation and its supporting structures, or the total number of units in the condominium building times $250,000, whichever is less.

The dwelling policy provides individual unit owners with supplemental building coverage to the RCBAP. The policies are coordinated such that the dwelling policy purchased by the unit owner responds to shortfalls on building coverages pertaining either to improvements owned by the insured unit owner or to assessments. However, the dwelling policy does not extend the RCBAP limits, nor does it enable the condominium association to fill in gaps in coverage.

Example: Lender makes a loan in the principal amount of $300,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost of $15 million and insured by an RCBAP with $12.5 million of coverage.

- Outstanding principal balance of loan is $300,000;
- Maximum amount of coverage available under the NFIP, which is the lesser of:
  - Maximum limit available for the residential condominium unit is $250,000; or
  - Insurable value of the unit based on 100 percent of the building's replacement cost value ($15 million / 50 = $300,000).

The lender does not need to require additional flood insurance since the RCBAP's $250,000 per unit coverage ($12.5 million / 50 = $250,000) satisfies the Regulation's mandatory flood insurance requirement. (This is the lesser of the outstanding principal balance ($300,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($300,000).)

The guidance in question and answer 24 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 flood insurance in an amount less than required by the Regulation, and as set forth in proposed question and answer 24, at the first flood insurance policy renewal period following the effective date of the revised guidance.

25. What action must a lender take if there is no RCBAP coverage?

Answer: If there is no RCBAP, either because the condominium association will not obtain a policy or because individual unit owners are responsible for obtaining their own insurance, then the lender must require the individual unit owner/borrower to obtain a dwelling policy in an amount sufficient to meet the requirements outlined in Question 24.

Example: The lender makes a loan in the principal amount of $175,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost value of $10 million; however, there is no RCBAP.

- Outstanding principal balance of loan is $175,000.
- Maximum amount of coverage available under the NFIP, which is the lesser of:
  - Maximum limit available for the residential condominium unit is $250,000; or
  - Insurable value of the unit based on 100 percent of the building's replacement cost value ($10 million / 50 = $200,000).

The lender must require the individual unit owner/borrower to purchase a flood insurance dwelling policy in the amount of $175,000, since there is no RCBAP, to satisfy the Regulation's mandatory flood insurance requirement. (This is the lesser of the outstanding principal balance [[**Page** 15271]] ($175,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($200,000).)

26. What action must a lender take if the RCBAP coverage is insufficient to meet the Regulation's mandatory purchase requirements for a loan secured by an individual residential condominium unit?

Answer: If the lender determines that flood insurance coverage purchased under the RCBAP is insufficient to meet the Regulation's mandatory purchase requirements, then the lender should request the individual unit owner/borrower to ask the condominium association to obtain additional coverage that would be sufficient to meet the Regulation's requirements (see Question 24). If the condominium association does not obtain sufficient coverage, then the lender must require the individual unit owner/borrower to purchase a dwelling policy in an amount sufficient to meet the Regulation's flood insurance requirements. The amount of coverage under the dwelling policy required to be purchased by the individual unit owner would be the difference between the RCBAP's coverage allocated to that unit and the Regulation's mandatory flood insurance requirements (see Question 24).

Example: Lender makes a loan in the principal amount of $300,000 secured by a condominium unit in a 50-unit condominium building, which
is located in an SFHA within a participating community, with a replacement cost value of $10 million; however, the RCBAP is at 80 percent of replacement cost value ($8 million or $160,000 per unit).

- Outstanding principal balance of loan is $300,000
- Maximum amount of coverage available under the NFIP, which is the lesser of:
  - Maximum limit available for the residential condominium unit is $250,000; or
  - Insurable value of the unit based on 100 percent of the building's replacement value ($10 million / 50 = $200,000).

The lender must require the individual unit owner/borrower to purchase a flood insurance dwelling policy in the amount of $40,000 to satisfy the Regulation's mandatory flood insurance requirement of $200,000. (This is the lesser of the outstanding principal balance ($300,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($200,000).) The RCBAP fulfills only $160,000 of the Regulation's flood insurance requirement.

While the individual unit owner's purchase of a separate dwelling policy that provides for adequate flood insurance coverage under the Regulation will satisfy the Regulation's mandatory flood insurance requirements, the lender and the individual unit owner/borrower may still be exposed to additional risk of loss. Lenders are encouraged to apprise borrowers of this risk. The dwelling policy provides individual unit owners with supplemental building coverage to the RCBAP. The policies are coordinated such that the dwelling policy purchased by the unit owner responds to shortfalls on building coverages pertaining either to improvements owned by the insured unit owner or to assessments. However, the dwelling policy does not extend the RCBAP limits, nor does it enable the condominium association to fill in gaps in coverage.

The risk arises because the individual unit owner's dwelling policy may contain claim limitations that prevent the dwelling policy from covering the individual unit owner's share of the co-insurance penalty, which is triggered when the amount of insurance under the RCBAP is less than 80 percent of the building's replacement cost value at the time of loss. In addition, following a major flood loss, the insured unit owner may have to rely upon the condominium association's and other unit owners' financial ability to make the necessary repairs to common elements in the building, such as electricity, heating, plumbing, elevators, etc. It is incumbent on the lender to understand these limitations.

27. What must a lender do when a loan secured by a residential condominium unit is in a complex whose condominium association allows its existing RCBAP to lapse?

Answer: 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 that required under the Act and the Regulation, the lender must notify the individual unit owner/borrower of the requirement to maintain flood insurance coverage sufficient to meet the Regulation's mandatory requirements. The lender should encourage the individual unit owner/borrower to work with the condominium association to acquire a new RCBAP in an amount sufficient to meet the Regulation's mandatory flood insurance requirement (see Question 24). Failing that, the lender must require the individual unit owner/borrower to obtain a flood insurance dwelling policy in an amount sufficient to meet the Regulation's mandatory flood insurance requirement (see Questions 25 and 26). If the borrower/unit owner or the condominium association fails to purchase flood insurance sufficient to meet the Regulation's mandatory requirements within 45 days of the lender's notification to the individual unit owner/borrower of inadequate insurance coverage, the lender must force place the necessary flood insurance.

28. How does the RCBAP's co-insurance penalty apply in the case of residential condominiums, including those located in multi-story condominium complexes?

Answer: In the event the RCBAP's coverage on a condominium building at the time of loss is less than 80 percent of either the building's replacement cost or the maximum amount of insurance available for that building under the NFIP (whichever is less), then the loss payment, which is subject to a co-insurance penalty, is determined as follows (subject to all other relevant conditions in this policy, including those pertaining to valuation, adjustment, settlement, and payment of loss):

A. Divide the actual amount of flood insurance carried on the condominium building at the time of loss by 80 percent of either its replacement cost or the maximum amount of insurance available for the building under the NFIP, whichever is less.

B. Multiply the amount of loss, before application of the deductible, by the figure determined in A above.

C. Subtract the deductible from the figure determined in B above.

The policy will pay the amount determined in C above, or the amount of insurance carried, whichever is less.

Example 1: (inadequate insurance amount to avoid penalty)

Replacement value of the building--$250,000
80% of replacement value of the building--$200,000
Actual amount of insurance carried--$180,000
Amount of the loss--$150,000
Deductible--$500
Step A: 180,000 / 200,000 = .90
(90% of what should be carried to avoid co-insurance penalty)
Step B: 150,000 x .90 = 135,000
Step C: 135,000 - 500 = 134,500

The policy will pay no more than $134,500. The remaining $15,500 is not covered due to the co-insurance penalty ($15,000) and application of the deductible ($500). Unit owners' dwelling policies will not cover any [[**Page** 15272]] assessment that may be imposed to cover the costs of repair that are not covered by the RCBAP.

Example 2: (adequate insurance amount to avoid penalty)

Replacement value of the building--$250,000
80% of replacement value of the building--$200,000
Actual amount of insurance carried--$200,000
Amount of the loss--$150,000
Deductible--$500
Step A: 200,000 / 200,000 = 1.00
(100% of what should be carried to avoid co-insurance penalty)
Step B: 150,000 x 1.00 = 150,000
Step C: 150,000 - 500 = 149,500

In this example there is no co-insurance penalty, because the actual amount of insurance carried meets the 80 percent requirement to avoid the co-insurance penalty. The policy will pay no more than $149,500 ($150,000 amount of loss minus the $500 deductible). This example also assumes a $150,000 outstanding principal loan balance.

29. What are the major factors involved with the individual unit owner's dwelling policy's coverage limitations with respect to the condominium association's RCBAP coverage?

Answer: The following examples demonstrate how the unit owner's dwelling policy may cover in certain loss situations:

Example 1: (RCBAP insured to at least 80 percent of building replacement cost)

- If the unit owner purchases building coverage under the dwelling policy and if there is an RCBAP covering at least 80 percent of the building replacement cost value, the loss assessment coverage under the dwelling policy will pay that part of a loss that exceeds 80 percent of the association's building replacement cost allocated to that unit.
- The loss assessment coverage under the dwelling policy will not cover the association's policy deductible purchased by the condominium association.
- If building elements within units have also been damaged, the dwelling policy pays to repair building elements after the RCBAP limits that apply to the unit have been exhausted. Coverage combinations cannot exceed the total limit of $250,000 per unit.

Example 2: (RCBAP insured to less than 80 percent of building replacement cost)

- If the unit owner purchases building coverage under the dwelling policy and there is an RCBAP that was insured to less than 80 percent of the building replacement cost value at the time of loss, the loss assessment coverage cannot be used to reimburse the association for its co-insurance penalty.
- Loss assessment is available only to cover the building damages in excess of the 80-percent required amount at the time of loss. Thus, the covered damages to the condominium association building must be greater than 80 percent of the building replacement cost value at the time of loss before the loss assessment coverage under the dwelling policy becomes available. Under the dwelling policy, covered repairs to the unit, if applicable, would have priority in payment over loss assessments against the unit owner.

Example 3: (No RCBAP)

- If the unit owner purchases building coverage under the dwelling policy and there is no RCBAP, the dwelling policy covers assessments against unit owners for damages to common areas up to the dwelling policy limit.
- However, if there is damage to the building elements of the unit as well, the combined payment of unit building damages, which would apply first, and the loss assessment may not exceed the building coverage limit under the dwelling policy.

VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA

30. Is a home equity loan considered a designated loan that requires flood insurance?

Answer: Yes. A home equity loan is a designated loan, regardless of the lien priority, if the loan is secured by a building or a mobile home located in an SFHA in which flood insurance is available under the Act.

31. Does a draw against an approved line of credit secured by a building or mobile home, which is located in an SFHA in which flood insurance is available under the Act, require a flood determination under the Regulation?

Answer: No. While a line of credit, secured by a building or mobile home located in an SFHA in which flood insurance is available under the
Act, is a designated loan and, therefore, requires a flood determination when application is made for the loan, draws against an approved line do not require further determinations. However, a request made for an increase in an approved line of credit may require a new determination, depending upon whether a previous determination was done. (See the response to Question 61 in Section XIII. Required use of Standard Flood Hazard Determination Form).

32. When a lender makes a second mortgage secured by a building or mobile home located in an SFHA, how much flood insurance must the lender require?

Answer: A lender must ensure that adequate flood insurance is in place or require that additional flood insurance coverage be added to
the flood insurance policy 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 Act (currently $250,000 for a residential building and $500,000 for a nonresidential building),
or the insurable value of the building or mobile home. The lender on the second mortgage cannot comply with the Act and Regulation 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.

Example 1: Lender A makes a first mortgage with a principal balance of $100,000, but improperly requires only $75,000 of flood insurance
coverage. Lender B issues a second mortgage with a principal balance of $50,000. The insurable value of the residential building securing the
loans is $200,000. Lender B must ensure that flood insurance in the amount of $150,000 is purchased and maintained. If Lender B were to
require flood insurance only in an amount equal to the principal balance of the second mortgage ($50,000), its interest in the secured
property would not be fully protected in the event of a flood loss because Lender A would have prior claim on the entire $100,000 of the
loss payment towards its principal balance of $100,000, while Lender B would receive only $25,000 of the loss payment toward its principal
balance of $50,000.

Example 2: Lender A, who is not directly covered by the Act or Regulation, makes a first mortgage with a principal balance of $100,000
and does not require flood insurance. Lender B, who is directly covered by the Act and Regulation, issues a second mortgage with a principal

balance of $50,000. The insurable value of the residential building securing the loans is $200,000. Lender B must ensure that flood insurance in the amount of $150,000 is purchased and maintained. If Lender B were to require flood insurance only in an amount equal to the principal balance of the second [[**Page** 15273]] mortgage ($50,000), its interest in the secured property would not be protected in the event of a flood loss because Lender A would have prior claim on the entire $50,000 loss payment towards its principal balance of $100,000.

Example 3: Lender A made a first mortgage with a principal balance of $100,000 on real property with a fair market value of $150,000. The insurable value of the residential building on the real property is $90,000; however, Lender A improperly required only $70,000 of flood insurance coverage. Lender B later takes a second mortgage on the property with a principal balance of $10,000. Lender B must ensure that flood insurance in the amount of $90,000 is purchased and maintained on the secured property to comply with the Act and Regulation.

33. If a borrower requesting a home equity loan secured by a junior lien provides evidence that flood insurance coverage is in place, does the lender have to make a new determination? Does the lender have to adjust the insurance coverage?

Answer: It depends. Assuming the requirements in Section 528 of the Act (42 U.S.C. 4104b) are met and the same lender made the first mortgage, then a new determination may not be necessary, when the existing determination is not more than seven years old, there have been no map changes, and the determination was recorded on an SFHDF. If, however, a lender other than the one that made the first mortgage loan is making the home equity loan, a new determination would be required because this lender would be deemed to be ``making'' a new loan. In either situation, the lender will need to determine whether the amount of insurance in force is sufficient to cover the lesser of the combined outstanding principal balance of all loans (including the home equity loan), the insurable value, or the maximum amount of coverage available on the improved real estate.

34. If the loan request is to finance inventory stored in a building located within an SFHA, but the building is not security for the loan, is flood insurance required?

Answer: No. The Act and the Regulation provide that a lender shall not make, increase, extend, or renew a designated loan, that is a loan secured by a building or mobile home located or to be located in an SFHA, ``unless the building or mobile home and any personal property securing such loan'' is covered by flood insurance for the term of the loan. In this example, the collateral is not the type that could secure a designated loan because it does not include a building or mobile home; rather, the collateral is the inventory alone.

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.

36. If a loan is secured by Building A, which is located in an SFHA, and contents, which are located in Building B, is flood insurance required on the contents securing a loan?

Answer: No. If collateral securing the loan is stored in Building B, which does not secure the loan, then flood insurance is not required on those contents whether or not Building B is located in an SFHA.

37. Does the Regulation apply where the lender takes a security interest in a building or mobile home located in an SFHA only as an ``abundance of caution''?

Answer: Yes. The Act and Regulation look to the collateral securing the loan. If the lender takes a security interest in improved real estate located in an SFHA, then flood insurance is required.

38. If a borrower offers a note on a single-family dwelling as collateral for a loan but the lender does not take a security interest in the dwelling itself, is this a designated loan that requires flood insurance?

Answer: No. A designated loan is a loan secured by a building or mobile home. In this example, the lender did not take a security interest in the building; therefore, the loan is not a designated loan.

39. If a lender makes a loan that is not secured by real estate, but is made on the condition of a personal guarantee by a third party who gives the lender a security interest in improved real estate owned by the third party that is located in an SFHA in which flood insurance is available, is it a designated loan that requires flood insurance?

Answer: Yes. The making of a loan on condition of a personal guarantee by a third party and further secured by improved real estate, which is located in an SFHA, owned by that third party is so closely tied to the making of the loan that it is considered a designated loan that requires flood insurance.

VIII. Flood Insurance Requirements for Loan Syndications/Participations

40. How do the Agencies enforce the mandatory purchase requirements under the Act and Regulation when a lender participates in a loan syndication/participation?

Answer: Although a syndication/participation agreement may assign compliance duties to the lead lender or agent, and include clauses in
which the lead lender or agent indemnifies participating lenders against flood losses, each participating lender remains individually responsible for ensuring compliance with the Act and Regulation. Therefore, the Agencies will examine whether the regulated institution/participating lender 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.

IX. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or its Servicing Rights

41. How do the flood insurance requirements under the Regulation apply to lenders under the following scenarios involving loan servicing?

Scenario 1: A regulated lender originates a designated loan secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act. The lender makes the initial flood determination, provides the borrower with appropriate notice, and flood insurance is obtained. The lender initially services the loan; however, the lender subsequently sells both the loan and the servicing rights to a non-regulated party. What are the regulated lender's requirements under the Regulation? What are the regulated lender's requirements under the Regulation if it only transfers or sells the servicing rights, but retains ownership of the loan?

Answer: The lender must comply with all requirements of the Regulation, including making the initial flood determination, providing appropriate notice to the borrower, and ensuring that the proper amount of insurance is obtained. In the event the lender sells or transfers the loan and servicing rights, the lender must provide notice of the identity of the new servicer to FEMA or its designee.

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If the lender retains ownership of the loan and only transfers or sells the servicing rights to a non-regulated party, the lender must notify FEMA or its designee of the identity of the new servicer. The servicing contract should require the servicer to comply with all the requirements that are imposed on the lender as owner of the loan, including escrow of insurance premiums and forced placement of insurance, if necessary.

Generally, the Regulation does not impose obligations on a loan servicer independent from the obligations it imposes on the owner of a loan. Loan servicers are covered by the escrow, forced placement, and flood hazard determination fee provisions of the Act and Regulation primarily so that they may perform the administrative tasks for the lender, without fear of liability to the borrower for the imposition of unauthorized charges. In addition, the preamble to the Regulation emphasizes that the obligation of a loan servicer to fulfill administrative duties with respect to the flood insurance requirements arises from the contractual relationship between the loan servicer and the lender or from other commonly accepted standards for performance of servicing obligations. The lender remains ultimately liable for fulfillment of those responsibilities, and must take adequate steps to ensure that the loan servicer will maintain compliance with the flood insurance requirements.

Scenario 2: A non-regulated lender originates a designated loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act. The non-regulated lender does not make an initial flood determination or notify the borrower of the need to obtain insurance. The non-regulated lender sells the loan and servicing rights to a regulated lender. What are the regulated lender's requirements under the Regulation? What are the regulated lender's requirements if it only purchases the servicing rights?

Answer: A regulated lender's purchase of a loan and servicing rights, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, is not an event that triggers any requirements under the Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. The Regulation's requirements are triggered when a lender makes, increases, extends, or renews a designated loan. A lender's purchase of a loan does not fall within any of those categories. However, if a regulated lender becomes aware at any point during the life of a designated loan that flood insurance is required, then the lender must comply with the Regulation, including force placing insurance, if necessary. Similarly, if the lender subsequently extends, increases, or renews a designated loan, the lender must also comply with the Regulation.

Where a regulated lender purchases only the servicing rights to a loan originated by a non-regulated lender, the regulated lender is obligated only to follow the terms of its servicing contract with the owner of the loan. In the event the regulated lender subsequently sells or transfers the servicing rights on that loan, the lender must notify FEMA or its designee of the identity of the new servicer, if required to do so by the servicing contract with the owner of the loan.

42. When a lender makes a designated loan and will be servicing that loan, what are the requirements for notifying the Director of FEMA or the Director's designee?

Answer: FEMA stated in a June 4, 1996, letter that the Director's designee is the insurance company issuing the flood insurance policy.
The borrower's purchase of a policy (or the lender's forced placement of a policy) will constitute notice to FEMA when the lender is servicing that loan.

In the event the servicing is subsequently transferred to a new servicer, the lender must provide notice to the insurance company of the identity of the new servicer no later than 60 days after the effective date of such a change.

43. Would a RESPA Notice of Transfer sent to the Director of FEMA (or the Director's designee) satisfy the regulatory provisions of the Act?

Answer: Yes. The delivery of a copy of the Notice of Transfer or any other form of notice is sufficient if the sender includes, on or with the notice, the following information that FEMA has indicated is needed by its designee:

- Borrower's full name;
- Flood insurance policy number;
- Property address (including city and state);
- Name of lender or servicer making notification;
- Name and address of new servicer; and
- Name and telephone number of contact person at new servicer.

44. Can delivery of the notice be made electronically, including batch transmissions?

Answer: Yes. The Regulation specifically permits transmission by electronic means. A timely batch transmission of the notice would also be permissible, if it is acceptable to the Director's designee.

45. If the loan and its servicing rights are sold by the lender, is the lender required to provide notice to the Director or the Director's designee?

Answer: Yes. Failure to provide such notice would defeat the purpose of the notice requirement because FEMA would have no record of
the identity of either the owner or servicer of the loan.

46. Is a lender required to provide notice when the servicer, not the lender, sells or transfers the *servicing rights to another servicer?*

Answer: No. After servicing rights are sold or transferred, subsequent notification obligations are the responsibility of the new servicer. The obligation of the lender to notify the Director or the Director's designee of the identity of the servicer transfers to the new servicer. The duty to notify the Director or the Director's designee of any subsequent sale or transfer of the servicing rights and responsibilities belongs to that servicer. For example, a financial institution makes and services the loan. It then sells the loan in the secondary market and also sells the servicing rights to a mortgage company. The financial institution notifies the Director's designee of the identity of the new servicer and the other information requested by FEMA so that flood insurance transactions can be properly administered by the Director's designee. If the mortgage company later sells the servicing rights to another firm, the mortgage company, not the financial institution, is responsible for notifying the Director's designee of the identity of the new servicer.

47. In the event of a merger of one lending institution with another, what are the responsibilities of the parties for notifying the Director's designee?

Answer: If an institution is acquired by or merges with another institution, the duty to provide notice for the loans being serviced by the acquired institution will fall to the successor institution in the event that notification is not provided by the acquired institution prior to the effective date of the acquisition or merger.

X. Escrow Requirements

48. Are multi-family buildings or mixed-use properties included in the definition of ``residential improved real estate'' under the Regulation for which escrows are required?

Answer: ``Residential improved real estate'' is defined under the Regulation as ``real estate upon which a home or other residential building is located or to be located.'' A loan secured by residential improved real estate located or to be located in an SFHA in which flood insurance is available is a [[**Page** 15275]] designated loan. Lenders are required to escrow flood insurance premiums and fees for any mandatory flood insurance for such loans if the lender requires the escrow of taxes, hazard insurance premiums or other loan charges for loans secured by residential improved real estate.

Multi-family buildings. For the purposes of the Act and the Regulation, the definition of residential improved real estate does not make a distinction between whether a building is single- or multi-family, or whether a building is owner- or renter-occupied. The preamble to the Regulation indicates that single-family dwellings (including mobile homes), two-to-four family dwellings, and multi-family properties containing five or more residential units are covered under the Act's escrow provisions. If the building securing the loan meets the Regulation's definition of residential improved real estate, and the lender requires the escrow of other items, such as taxes or hazard insurance premiums, then the lender is required to also escrow premiums and fees for flood insurance.

Mixed-use properties. The lender should look to the primary use of a building to determine whether it meets the definition of ``residential improved real estate.'' For example, a building having a retail store on the ground level with a small upstairs apartment used by the store's owner generally is considered a commercial enterprise and consequently would not constitute a residential building under the definition. If the primary use of a mixed-use property is for residential purposes, the Regulation's escrow requirements apply. (See Questions 8 and 9 for examples of residential and nonresidential buildings.)

49. When must escrow accounts be established for flood insurance purposes?

Answer: Lenders should look to the definition of ``federally related mortgage loan'' contained in the Real Estate Settlement Procedures Act (RESPA) to see whether a particular loan is subject to Section 10. Generally, for flood insurance purposes, only loans on one-to-four family dwellings will be subject to the escrow requirements of RESPA. (This includes individual units of condominiums. Individual units of cooperatives, although covered by Section 10 of RESPA, are not insured for flood insurance purposes.)

Loans on multi-family dwellings with five or more units are not covered by RESPA requirements. Pursuant to the Regulation, however, lenders must escrow premiums and fees for any required flood insurance if the lender requires escrows for other purposes, such as hazard insurance or taxes. This requirement pertains to any loan, including those subject to RESPA. The preceding paragraph addresses the requirement for administering loans covered by RESPA. The preamble to the Regulation contains a more detailed discussion of the escrow requirements.

50. Do voluntary escrow accounts established at the request of the borrower trigger a requirement for the lender to escrow premiums for required flood insurance?

Answer: No. If escrow accounts for other purposes are established at the voluntary request of the borrower, the lender is not required to establish escrow accounts for flood insurance premiums. Examiners should review the loan policies of the lender and the underlying legal obligation between the parties to the loan to determine whether the accounts are, in fact, voluntary. For example, when a lender's loan policies require borrowers to establish escrow accounts for other purposes and the contractual obligation permits the lender to establish escrow accounts for those other purposes, the lender will have the burden of demonstrating that an existing escrow was made pursuant to a voluntary request by the borrower.

51. Will premiums paid for credit life insurance, disability insurance, or similar insurance programs be viewed as escrow accounts requiring the escrow of flood insurance premiums?

Answer: No. Premiums paid for these types of insurance policies will not trigger the escrow requirement for flood insurance premiums.

52. Will escrow-type accounts for commercial loans, secured by multi-family residential buildings, trigger the escrow requirement for flood insurance premiums?

Answer: It depends. Escrow-type accounts established in connection with the underlying agreement between the buyer and seller, or that relate to the commercial venture itself, such as ``interest reserve accounts,'' ``compensating balance accounts,'' ``marketing accounts,'' and similar accounts are not the type of accounts that constitute escrow accounts for the purpose of the Regulation. However, escrow accounts established for the protection of the property, such as escrows for hazard insurance premiums or local real estate taxes, are the types of escrow accounts that trigger the requirement to escrow flood insurance premiums.

53. What requirements for escrow accounts apply to properties covered by RCBAPs?

Answer: RCBAPs are policies purchased by the condominium association on behalf of itself and the individual unit owners in the condominium. A portion of the periodic dues paid to the association by the condominium owners applies to the premiums on the policy. When a lender makes a loan for the purchase of a condominium unit and when dues to the condominium association apply to the RCBAP premiums, an escrow account is not required. Lenders should exercise due diligence with respect to continuing compliance with the insurance requirements on the part of the condominium association.

XI. Forced Placement of Flood Insurance

54. What is the requirement for the forced placement of flood insurance under the Act and Regulation?

Answer: The Act and Regulation require a lender to force place flood insurance, if all of the following circumstances occur:

- The lender determines at any time during the life of the loan that the property securing the loan is located in an SFHA;
- The community in which the property is located participates in the NFIP;
- The lender determines that flood insurance coverage is inadequate or does not exist; and
- After required notice, the borrower fails to purchase the appropriate amount of coverage.

A lender must notify the borrower of the required amount of flood insurance that must be obtained within 45 days after notification. The notice to the borrower must also state that if the borrower does not obtain the insurance within the 45-day period, the lender will purchase the insurance on behalf of the borrower and may charge the borrower the cost of premiums and fees to obtain the coverage. If adequate insurance is not obtained within the 45-day period, then the insurance must be force placed. Standard Fannie Mae/Freddie Mac documents permit the servicer or lender to add those charges to the principal amount of the loan.

FEMA developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with forced placement procedures. FEMA published these procedures in the Federal Register on August 29, 1995 (60 FR 44881). Appendix A of the FEMA publication contains examples of notification letters to be used in connection with the MPPP.

55. Can a servicer force place on behalf of a lender?

[[**Page** 15276]]

Answer: Yes. Assuming the statutory prerequisites for forced placement are met, and subject to the servicing contract between the lender and the servicer, the Act clearly authorizes servicers to force place flood insurance on behalf of the lender, following the procedures set forth in the Regulation.

56. When forced placement occurs, what is the amount of insurance required to be placed?

Answer: The amount of flood insurance coverage required is the same regardless of how the insurance is placed. (See Section II. Determining the appropriate amount of flood insurance required under the Act and Regulation.)

XII. Gap Insurance Policies

57. May a lender rely on a gap or blanket insurance policy to meet its obligation to ensure that its designated loans are covered by an adequate amount of flood insurance over the life of the loans?

Answer: Generally no. Gap or blanket insurance typically is not an adequate substitute for NFIP insurance. Among other things, a gap or
blanket policy typically protects only the lender's, not the borrower's, interest and, therefore, may not be transferred when a loan is sold. The presence of a gap or blanket policy may serve as a disincentive for the lender or its servicer to perform its due diligence and ensure that there is adequate coverage for a designated loan. Finally, a lender that substitutes a gap or blanket policy for an individual flood insurance policy would be unable to sell the loan in the secondary market, since Fannie Mae and Freddie Mac will not accept loans that are covered solely by a gap or blanket policy.

In limited circumstances, a gap or blanket policy may satisfy a lender's flood insurance obligations, when NFIP and private insurance is otherwise unavailable. For example, when a designated loan does not have sufficient coverage, but the borrower refuses to increase coverage under his NFIP insurance, a gap or blanket policy may be appropriate when the lender is unable to force-place private insurance for some reason. Similarly, when a policy has expired, and the borrower has failed to renew coverage, gap or blanket coverage may be adequate protection for the lender for the 15-day gap in coverage between the end of the 30-day ``grace'' period after the NFIP policy expiration and the end of the 45-day force placement notice period. However, the lender must force place adequate coverage in a timely manner, as required, and may not rely on the gap or blanket coverage on an on-going basis.

XIII. Required Use of Standard Flood Hazard Determination Form (SFHDF)

58. Does the SFHDF replace the borrower notification form?

Answer: No. The notification form is used to notify the borrower(s) that he or she is purchasing improved property located in an SFHA. The
financial regulatory Agencies, in consultation with FEMA, included a revised version of the sample borrower notification form in Appendix A
to the Regulation. The SFHDF is used by the lender to determine whether the property securing the loan is located in an SFHA.

59. Is the lender required to provide the SFHDF to the borrower?

Answer: No. While it may be a common practice in some areas for lenders to provide a copy of the SFHDF to the borrower to give to the
insurance agent, lenders are neither required nor prohibited from providing the borrower with a copy of the form. In the event a lender
does provide the SFHDF to the borrower, the signature of the borrower is not required to acknowledge receipt of the form.

60. May the SFHDF be used in electronic format?

Answer: Yes. FEMA, in the final rule adopting the SFHDF stated: ``If an electronic format is used, the format and exact layout of the
Standard Flood Hazard Determination Form is not required, but the fields and elements listed on the form are required. Any electronic
format used by lenders must contain all mandatory fields indicated on the form.'' It should be noted,

however, that the lender must be able
to reproduce the form upon receiving a document request by its federal supervisory agency.

61. Section 528 of the Act, 42 U.S.C. 4104b(e), permits a lender to rely on a previous flood determination using the SFHDF when it is increasing, extending, renewing or purchasing a loan secured by a building or a mobile home. Under the Act, the ``making'' of a loan is not listed as a permissible event that permits a lender to rely on a previous determination. May a lender rely on a previous determination for a refinancing or assumption of a loan?

Answer: It depends. When the loan involves a refinancing or assumption by the same lender who obtained the original flood determination on the same property, the lender may rely on the previous determination only if the original determination was made not more than seven years before the date of the transaction, the basis for the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made. A loan refinancing or assumption made by a lender different from the one who obtained the original determination constitutes a new loan, thereby requiring a new determination.

XIV. Flood Determination Fees

62. When can lenders or servicers charge the borrower a fee for making a determination?

Answer: There are four instances under the Act and Regulation when the borrower can be charged a specific fee for a flood determination:

- When the determination is made in connection with the making, increasing, extending, or renewing of a loan that is initiated by the borrower;
- When the determination is prompted by a revision or updating by FEMA of floodplain areas or flood-risk zones;
- When the determination is prompted by FEMA's publication of notices or compendia that affect the area in which the security property is located; or
- When the determination results in forced placement of insurance.

Loan or other contractual documents between the parties may also permit the imposition of fees.

63. May charges made for life of loan reviews by flood determination firms be passed along to the borrower?

Answer: Yes. In addition to the initial determination at the time a loan is made, increased, renewed, or extended, many flood determination
firms provide a service to the lender to review and report changes in the flood status of a dwelling for the entire term of the loan. The fee
charged for the service at loan closing is a composite one for conducting both the original and subsequent reviews. Charging a fee for
the original determination is clearly within the permissible purpose envisioned by the Act. The Agencies agree that a determination fee may
include, among other things, reasonable fees for a lender, servicer, or third party to monitor the flood hazard status of property securing a
loan in order to make determinations on an ongoing basis.

However, the life-of-loan fee is based on the authority to charge a determination fee and, therefore, the

monitoring fee may be charged
only if the events specified in the answer to Question 62 occur.

XV. Flood Zone Discrepancies

*64. What should a lender do when there is a discrepancy between the flood hazard zone designation on the flood [[**Page** 15277]] determination form and the flood insurance policy?*

Answer: Lenders should have a process in place to identify and resolve such discrepancies. In attempting to resolve a particular discrepancy, a lender should determine whether there may be a legitimate reason for a discrepancy.

The flood determination form designates a flood hazard zone where the building or mobile home is actually located based on the latest FEMA information; the flood insurance policy designates the flood hazard zone for purposes of rating the degree of flood hazard risk. The two respective flood hazard zone designations may legitimately differ by virtue of 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 for the particular flood zone where the property is located. The Grandfather Rule allows policyholders who have maintained continuous coverage and/or who have built in compliance with the Flood Insurance Rate Map to continue to benefit from the prior, more favorable rating for particular pieces of improved property. A discrepancy caused as a result of the application of the NFIP's Grandfather Rule is reasonable and acceptable. In such an event where the lender determines that there is a legitimate reason for the discrepancy, it should document its findings.

If the lender is unable to reconcile a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy and there is no legitimate reason for the discrepancy, the lender and borrower may jointly request that FEMA review the determination. This procedure is intended to confirm or disprove the accuracy of the original determination. The procedures for initiating a FEMA review are found at 44 CFR 65.17. This request must be submitted within 45 days of the lender's notification to the borrower of the requirement to obtain flood insurance.

65. Can a lender be found in violation of the requirements of 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 need to obtain flood insurance, and requiring mandatory flood insurance, there is a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy?

Answer: Yes. As noted in Question 64 above, lenders should have a process in place to identify and resolve such discrepancies. If a lender is able to resolve a discrepancy--either by finding a legitimate reason for such discrepancy or by attempting to resolve the discrepancy by contacting FEMA to review the determination, then no violation will be cited. However, 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. Failure to resolve such discrepancies could result in the lender's collateral not being covered by the amount of legally required flood insurance.

XVI. Notice of Special Flood Hazards and Availability of Federal Disaster Relief

66. Does the notice have to be provided to each borrower for a real estate related loan?

Answer: No. In a transaction involving multiple borrowers, the lender need only provide the notice to any one of the borrowers in the transaction. Lenders may provide multiple notices if they choose. The lender and borrower(s) typically designate the borrower to whom the notice will be provided. The notice must be provided to a borrower when the lender determines that the property securing the loan is or will be located in an SFHA.

67. Lenders making loans on mobile homes may not always know where the home is to be located until just prior to, or sometimes after, the time of loan closing. How is the notice requirement applied in these situations?

Answer: When it is not reasonably feasible to give notice before the completion of the transaction, the notice requirement can be met by lenders in mobile home loan transactions if notice is provided to the borrower as soon as practicable after determination that the mobile home will be located in an SFHA. Whenever time constraints can be anticipated, regulated lenders should use their best efforts to provide adequate notice of flood hazards to borrowers at the earliest possible time. In the case of loan transactions secured by mobile homes not located on a permanent foundation, the Agencies note that such ``home only'' transactions are excluded from the definition of mobile home and the notice requirements would not apply to these transactions.

However, as indicated in the preamble to the Regulation, the Agencies encourage a lender to advise the borrower that if the mobile home is later located on a permanent foundation in an SFHA, flood insurance will be required. If the lender, when notified of the location of the mobile home subsequent to the loan closing, determines that it has been placed on a permanent foundation and is located in an SFHA in which flood insurance is available under the Act, flood insurance coverage becomes mandatory and appropriate notice must be given to the borrower under those provisions. If the borrower fails to purchase flood insurance coverage within 45 days after notification, the lender must force place the insurance.

68. When is the lender required to provide notice to the servicer of a loan that flood insurance is required?

Answer: Because the servicer of a loan is often not identified prior to the closing of a loan, the Regulation requires that notice be provided no later than the time the lender transmits other loan data, such as information concerning hazard insurance and taxes, to the servicer.

69. What will constitute appropriate form of notice to the servicer?

Answer: Delivery to the servicer of a copy of the notice given to the borrower is appropriate notice. The Regulation also provides that the notice can be made either electronically or by a written copy.

70. In the case of a servicer affiliated with the lender, is it necessary to provide the notice?

Answer: Yes. The Act requires the lender to notify the servicer of special flood hazards and the Regulation reflects this requirement. Neither contains an exception for affiliates.

71. How long does the lender have to maintain the record of receipt by the borrower of the notice?

Answer: The record of receipt provided by the borrower must be maintained for the time that the lender owns the loan. Lenders may keep
the record in the form that best suits the lender's business practices. Lenders may retain the record electronically, but they must be able to

retrieve the record within a reasonable time pursuant to a document request from their federal supervisory agency.

72. Can a lender rely on a previous notice if it is less than seven years old and it is the same property, same borrower, and same lender?

Answer: No. The preamble to the Regulation states that subsequent transactions by the same lender with respect to the same property will
be treated as a renewal and will require no new determination. However, neither the Regulation nor the preamble addresses waiving the
requirement to [[**Page** 15278]] provide the notice to the borrower. Therefore, the lender must provide a new notice to the borrower, even if a new determination is not required.

73. Is use of the sample form of notice mandatory?

Answer: No. Although lenders are required to provide a notice to a borrower when it makes, increases, extends, or renews a loan secured by
an improved structure located in an SFHA, use of the sample form of notice provided in Appendix A is not mandatory. It should be noted that
the sample form includes other information in addition to what is required by the Act and the Regulation. Lenders may personalize, change
the format of, and add information to the sample form of notice, if they choose. However, a lender-revised notice must provide the borrower
with at least the minimum information required by the Act and Regulation. Therefore, lenders should consult the Act and Regulation to
determine the information needed.

XVII. Mandatory Civil Money Penalties

74. What violations of the Act can result in a mandatory civil money penalty?

Answer: A pattern or practice of violations of any of the following requirements of the Act and their implementing Regulations triggers a
mandatory civil money penalty:

(i) Purchase of flood insurance where available (42 U.S.C. 4012a(b));
(ii) Escrow of flood insurance premiums (42 U.S.C. 4012a(d));
(iii) Forced placement of flood insurance (42 U.S.C. 4012a(e));
(iv) Notice of special flood hazards and the availability of Federal disaster relief assistance (42 U.S.C. 4104a(a)); and
(v) Notice of servicer and any change of servicer (42 U.S.C. 4101a(b)).

The Act states that any regulated lending institution found to have a pattern or practice of certain violations ``shall be assessed a civil penalty'' by its Federal supervisor in an amount not to exceed $350 per violation, with a ceiling per institution of $100,000 during any calendar year (42 U.S.C. 4012a(f)(5)). This limit has since been raised to $385 per violation, and the annual ceiling to $125,000 pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, 28 U.S.C. 2461 note. Lenders pay the penalties into the National Flood Mitigation Fund held by the Department of the Treasury for the benefit of FEMA.

75. What constitutes a ``pattern or practice'' of violations for which civil money penalties must be imposed under the Act?

Answer: The Act does not define ``pattern or practice.'' The Agencies make a determination of whether one exists by weighing the individual facts and circumstances of each case. In making the determination, the Agencies look both to guidance and experience with determinations of pattern or practice under other regulations (such as Regulation B (Equal Credit Opportunity) and Regulation Z (Truth in Lending)), as well as Agencies' precedents in assessing civil money penalties for flood insurance violations.

The *Policy Statement on Discrimination in Lending* (Policy Statement) provided the following guidance on what constitutes a pattern or practice:

> Isolated, unrelated, or accidental occurrences will not constitute a pattern or practice. However, repeated, intentional, regular, usual, deliberate, or institutionalized practices will almost always constitute a pattern or practice. The totality of the circumstances must be considered when assessing whether a pattern or practice is present.

In determining whether a financial institution has engaged in a pattern or practice of flood insurance violations, the Agencies' considerations may include, but are not limited to, the presence of one or more of the following factors:

- Whether the conduct resulted from a common cause or source within the financial institution's control;
- Whether the conduct appears to be grounded in a written or unwritten policy or established practice;
- Whether the noncompliance occurred over an extended period of time;
- The relationship of the instances of noncompliance to one another (for example, whether the instances of noncompliance occurred in the same area of a financial institution's operations);
- Whether the number of instances of noncompliance is significant relative to the total number of applicable transactions. (Depending on the circumstances, however, violations that involve only a small percentage of an institution's total activity could constitute a pattern or practice);
- Whether a financial institution was cited for violations of the Act and Regulation at prior examinations and the steps taken by the financial institution to correct the identified deficiencies;
- Whether a financial institution's internal and/or external audit process had not identified and addressed deficiencies in its flood insurance compliance; and
- Whether the financial institution lacks generally effective flood insurance compliance policies and procedures and/or a training program for its employees.

Although these guidelines and considerations are not dispositive of a final resolution, they do serve as a reference point in assessing whether there may be a pattern or practice of violations of the Act and Regulation in a particular case. As previously stated, the presence or absence of one or more of these considerations may not eliminate a finding that a pattern or practice exists.

End of text of the Interagency Questions and Answers Regarding Flood Insurance.

Dated: March 5, 2008.
John C. Dugan,
Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, March 12, 2008.
Jennifer J. Johnson,
Secretary of the Board.

Dated at Washington, DC, this 14th day of March, 2008.
Federal Deposit Insurance Corporation.
Valerie J. Best,
Assistant Executive Secretary.

Dated: February 5, 2008.
By the Office of Thrift Supervision.
John M. Reich,
Director.

Dated: March 13, 2008.
Roland E Smith,
Secretary, Farm Credit Administration Board.

By the National Credit Union Administration Board, on March 13, 2008.
Mary F. Rupp,
Secretary of the Board.

73 FR 33931, 06/16/2008

Handbook Mailing HM-08-5

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 615

RIN 3052-AC42

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Mission-Related Investments, Rural Community Investments

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA) proposes a new rule that would authorize each Farm Credit System (Farm Credit, System, or FCS) bank, association, and service corporation (institution) to invest in rural communities across America under certain conditions. The proposed rule would allow each System institution to make investments in rural communities that are outside of an urbanized area only for specific purposes. Several provisions in the proposed rule would ensure that System investments in rural America are safe and sound and comply with the Farm Credit Act of 1971, as amended (Act), and other applicable statutes.

DATES: Comments should be received on or before August 15, 2008.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site or the Federal eRulemaking Portal. As faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, please consider another means to submit your comment if possible. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public

Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Laurie Rea, Associate Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA, (703) 883-4414, TTY (703) 883-4434;

or

Dawn Johnson, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, Denver, CO, (303) 696-9737, TTY (303) 696-9259;

or

Richard A. Katz, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. <u>Background</u>

The FCA proposes a new rule, § 615.5176, which would enable System institutions to more effectively serve the needs of rural communities by exercising investment powers under the Act. The proposed rule focuses on specific needs in rural communities. Essentially, the proposed rule would authorize two separate types of investments that System institutions could make in America's rural communities. First, System institutions could invest in debt securities that would involve projects or programs that benefit the public in rural communities. Equity investments in venture capital funds are the second type of investment that the proposed rule would authorize. Venture capital funds create new economic opportunities and jobs in rural communities by providing capital to small or start-up businesses.

The proposed rule would authorize each System institution to make investments in rural areas that according to the terms of the latest United States decennial census have fewer than 50,000 residents and are outside of an urbanized area. The proposed rule would allow System institutions to invest in: (1) Essential community facilities; (2) basic transportation infrastructure; (3) rural communities recovering from disasters; (4) debt securities for rural development projects that the United States, its agencies, any state, Puerto Rico, or a local municipal government sponsors or guarantees; (5) debt securities that support the rural development activities of non-System financial institutions; (6) rural business investment companies; and (7) venture capital funds that invest in rural businesses that create jobs and economic growth under specific conditions. The proposed rule also would allow System institutions to make other investments that are not expressly covered by this regulation with FCA approval. Under the proposed rule, an institution may hold rural community investments in an amount that does not exceed 150 percent of its total surplus. As discussed in greater detail below, other provisions of the proposed rule address safety and soundness and compliance with the Act.

A. <u>The Statutory Basis for the Proposed Rule</u>

System institutions derive their investment authorities from several provisions of the Act. Sections 1.5(15) and 3.1(13)(A) of the Act[1] authorize System banks to invest in securities of the United States and its agencies, and make "other investments as may be authorized under regulations issued by the Farm Credit Administration." Sections 2.2(10) and 2.12(18) of the Act[2] authorize System associations to invest their funds as approved by their district banks in accordance with FCA regulations. A System service corporation is authorized by section 4.25 of the Act[3] to engage in investment activities to the same extent as its System parents.[4]

Investments in rural communities are compatible with the System's statutory mandate. The preamble to the Act clearly states that Congress enacted the law "to provide for an adequate and flexible flow of money into rural areas, and to modernize . . . existing farm credit law to meet current and future rural credit needs, and for other purposes." The preamble and investment provisions of the Act form a broad statutory framework that confers considerable discretion on the FCA to decide the purposes, conditions, and limits for all investment activities at System institutions. In exercising this discretion, the FCA has authorized System institutions to invest their funds in obligations that are suitable for liquidity, risk management, and activities that are closely related to the System's statutory mandate.

In implementing the investment provisions of the Act, the FCA has taken a cautious and incremental approach in approving System investments for mission-related purposes. Since Congress enacted the Act in 1971, the FCA has approved new regulations and programs that authorize the System to make specified investments in agriculture and rural communities, subject to certain conditions and limits. The factors that the FCA considers whenever it decides to approve new mission-related investments are: (1) The financial needs of agriculture and rural communities; (2) new investment products offered in the marketplace; (3) the System's status as a Government-sponsored enterprise (GSE); and (4) compliance with the Act and other applicable statutes. Under FCA regulations and programs, System investments in agriculture and rural communities have remained small because lending to farmers, ranchers, cooperatives, and other eligible borrowers is the primary activity of System institutions under the Act. Additionally, most mission-related investments that the FCA has approved are related to the System's expertise in financing agriculture, rural housing, and infrastructure in rural areas.

Historically, the FCA has authorized System institutions to invest in debt securities, but not in equity securities of non-System entities. In 2002, Congress granted System institutions express authority to invest in rural business investment companies (RBICs), which are venture capital funds that the United States Department of Agriculture (USDA) funds and oversees. The FCA believes that allowing the System to invest in venture capital funds that hold small equity positions in start-up rural enterprises is consistent with congressional intent. As discussed in greater detail below, the proposed rule would implement the provisions of title VI of the Farm Security and Rural Investment Act of the 2002[5] and the Act by allowing System institutions to invest in RBICs and other venture capital funds that provide start-up money to rural entrepreneurs.

In accordance with the Act, the FCA has enacted several regulations since 1971 that authorize System investments in agriculture and America's rural communities. The first mission-related investments that the FCA approved were farmers' notes.[6] Since 1972, FCA regulations have authorized System banks and associations to invest in obligations of States, municipalities, and local governments. In 1993, a new regulation authorized System institutions to purchase and hold mortgage securities issued or guaranteed by the Federal Agricultural Mortgage Corporation (Farmer Mac). In 1999, the FCA amended another regulation to permit investment in asset securities backed by agricultural equipment. An existing regulation, § 615.5140(e), allows Farm Credit institutions to hold other investments that the FCA approves on a case-by-case basis. This regulatory framework guides investment practices at Farm Credit institutions and ensures that System investments comply with law and are safe and sound.

Since 2005, the FCA has approved requests by System banks and associations, on a case-by-case basis, to initiate pilot programs for investing in America's rural communities under specified conditions. Under these FCA-approved pilot programs, System institutions acquired expertise and became active in making investments that provided funding for essential projects in rural communities.

Based on the positive experience of these pilot programs, the FCA is proposing a rule that will allow all System banks, associations, and service corporations to make certain investments in rural communities under prescribed conditions without prior FCA approval. This proposed rule would permit the rural-based System to use its expertise and a portion of its financial resources to support rural economic growth and development by investing in those projects and programs in America's rural communities that often have difficulty attracting financing at affordable rates.

The proposed rule implements the investment provisions of the Act by ensuring that: (1) System institutions invest in rural communities only for specific purposes; and (2) all instruments purchased and held by Farm Credit institutions are investment securities in accordance with market practices and securities laws. Investments in rural communities also would be subject to a portfolio limit and other controls to ensure that FCS rural community investment activities comply with the Act and are safe and sound.

The FCA emphasizes that lending to farmers, ranchers, aquatic producers and harvesters, farm-related businesses, rural homeowners, cooperatives, and rural utilities remains the primary purpose of the System. However, within the parameters prescribed by the proposed rule, System investments, which help strengthen the economic viability of rural communities, are compatible with the preamble and several provisions of the Act. Investing in rural communities enables Farm Credit to fulfill its mission by helping sustain rural communities on which the System's borrowers and owners are dependent for their livelihoods.

B. <u>Why Investments in Rural Communities are Important</u>

The FCA proposes this rule to allow the System to make investments in rural communities and to support and supplement investments by government, commercial banks, investment banks, and venture capital funds. The FCA believes that this new rule will enable the System to more fully assist rural communities in financing projects that are designed to provide essential facilities, infrastructure, and services to residents. As discussed in greater detail below, System institutions made investments under FCA authorized pilot programs, which demonstrated that the FCS is both locally and regionally positioned to effectively participate and assist rural development networks that strive to address rural needs. The proposed rule is designed to enable FCS institutions to collaborate and partner in rural development initiatives that advance the System’s mission and its capacity to serve as a financial intermediary promoting the flow of money into rural areas.

Many rural communities are struggling to retain economic viability and vitality that can provide economic opportunities and a better quality of life for their residents. Rural communities face numerous demographic, social, and economic challenges in meeting the needs of their residents. As a result, rural communities often find it difficult to provide the essential facilities, infrastructure, and services that their residents need. For example, an aging population in rural areas requires medical and assisted health care facilities. However, rural communities often have fewer health care providers and facilities to meet the increasing medical needs of its growing elderly population.[7]

Also, a large gap persists between rural and metropolitan residents who have earned college degrees. This gap is reinforced by a lower demand for workers with post-secondary degrees in rural areas, which in turn, contributes to the out-migration of skilled workers.[8] These factors place rural communities at a disadvantage in attracting businesses that offer higher wages and better job benefits to employees. Essential facilities, infrastructure, and services in rural areas often lag behind those in metropolitan areas. This is another factor that limits the ability of rural communities to attract and retain businesses that provide employment and economic opportunities. These obstacles to rural economic development and revitalization are further compounded by funding challenges for projects that are designed to assist rural communities in resolving these problems.

Funding for economic growth and development projects in rural communities is available from a variety of sources, most notably the Federal and State governments, and private-sector financiers, including commercial and investment banks. Each of these entities faces challenges in providing rural communities with the funding needed for these projects. Efforts by Federal or State governments to help rural communities are often curtailed by budget constraints. Also, many rural community banks are willing to provide short-term funding, but find it difficult to provide the additional long-term capital investment needed for facilities in rural areas.[9] Essential facilities and large capital improvements, such as critical care access hospitals, require a large capital investment that is repaid over an extended period of time. In many cases, no single investor is willing and able to supply all of the capital necessary for such projects, and rural communities must depend on a combination of government and private-sector financial sources and local donations.[10] Another obstacle is that rural development projects in remote rural locations typically involve higher costs and greater risks, which deter investors. For these reasons, government and private-sector financial resources often are insufficient to fully fund many necessary and worthwhile projects that rural residents need.

System institutions are an integral part of rural America. The farmers and ranchers who borrow from and own the FCS live and work in rural communities. These System stockholders and their families depend on local rural communities for essential services, employment, and other economic opportunities. Today, the majority of farm household income is derived from off-farm sources.[11] As a result, farm families depend on local rural communities for employment that supplements farm income. Further, agricultural production is one of the most hazardous industrial sectors.[12] Farmers and ranchers confront the same problems as other residents of America's rural communities in obtaining access to quality hospitals, medical facilities, schools and essential services.

System institutions are active in financial markets that serve regional and local rural areas across the United States. For this reason, the System is familiar with the challenges that rural communities face in meeting the needs of both farm and nonfarm rural residents. The System has the financial capacity to invest in rural development, and this proposed rule would advance the System's contributions to rural development efforts.

C. <u>Investments in Rural Communities Made Under Pilot Programs</u>

Over the past 3 years, a number of System institutions have developed programs to make investments in rural communities through FCA-approved pilot programs. As a result of the investments made under these pilot programs, rural communities were able to address specific regional needs because these investments provided greater access to capital for community facilities, revitalization projects, and other economic development initiatives. These investments also provided additional liquidity into rural financial markets. In several cases, these investments helped provide capital at more affordable terms and rates, which in turn made these projects more feasible.

The pilot programs have demonstrated that Farm Credit institutions have the capacity and willingness to work collaboratively with rural communities and financial institutions to address local and regional rural economic development needs. As previously discussed, many rural development projects are reliant on multiple partners for success. In making rural community investments under the pilot programs, System institutions partnered with: Federal, State, and regional rural development authorities; non-System financial institutions including rural community banks; nonprofit organizations; and venture capital funds. For example, System investments under the pilot programs have provided capital for rural hospitals designated as critical access facilities, which were sponsored, in part, by the USDA's Rural Development Community Facilities Program. Other examples of specific System investments that have made a positive difference in rural communities include investments in: medical and mental clinics; treatment facilities for adolescents and adults; living and nursing centers for the elderly; schools; and community facilities. Several projects, which were sponsored by regional or State development authorities, modernized obsolete facilities for value-added agricultural products, or created new facilities to promote local economic growth. These projects were designed to promote economic growth in rural areas by attracting and promoting businesses that create or retain jobs in these rural communities.

Non-System financial institutions and venture capital funds have also benefited from investments that System institutions made under the pilot programs. For example, System institutions have helped to increase liquidity at several rural community banks by buying bonds that support the rural development efforts of these banks. These investments enabled these banks to reduce the long-term financing costs for specific rural development projects. Additionally, investments in regional investment networks provided venture capital to rural entrepreneurs for start-up businesses that contributed to the vitality of rural communities. System institutions were prudent in undertaking investment activities in rural communities and assumed reasonable risks within pilot program conditions.

In addition to the pilot programs, grant programs and charitable contributions at many System institutions complement their commitments to the citizens of local rural communities. Although the proposed rule does not specifically address grants, System institutions have authority under the incidental power provisions of the Act to make charitable grants and donations.[13] The FCA continues to encourage FCS institutions to consider making charitable donations and contributions to worthwhile causes in the communities they serve. System institutions have contributed to a wide variety of community organizations and entities, including emergency and medical services, agricultural and rural community development educational programs, and value-added agricultural product initiatives. Charitable grants by System institutions complement rural community investment programs and are an additional way for Farm Credit institutions to further the System's mission and help enhance the quality of life for residents in rural communities.

II. <u>Section-by-Section Analysis</u>

A. <u>Rural Communities</u>

Proposed § 615.5176(a) would authorize Farm Credit banks, associations, and service corporations to make rural community investments. Proposed § 615.5176(a) also provides that FCS institutions may make these investments only in areas <u>outside</u> of an "urbanized area"[14] as defined by the latest decennial census of the United States. For the purposes of this proposed rule, areas outside of an urbanized area are "rural." The proposed rule would authorize the FCS to make rural community investments in areas that the United States Census Bureau determined in the latest decennial census to have a population of less than 50,000 residents. For the purposes under this proposed rule, the geographic area includes any State within the United States and the Commonwealth of Puerto Rico.

The FCA considered numerous definitions of "rural," recognizing there is no single, universally preferred definition of "rural" that policymakers commonly use.[15] In fact, more than 15 definitions of "rural" are currently used by different Federal agencies for various programs.[16] In developing the proposed rule, the FCA relied on Census Bureau terminology to ensure that the geographic areas in which investments are permitted are readily identifiable and easily distinguished.

In determining which geographic areas should qualify under the proposed rule, the FCA seeks to include those areas with sufficient population densities to support health care and other essential facilities serving rural residents, while prohibiting investments in urbanized areas. For example, hospitals and other health care facilities that primarily serve rural geographic areas are typically located in areas that have less than 50,000 residents. Also, whenever Congress has expressly authorized FCS institutions to lend or invest in rural development projects, it has allowed these activities in communities with populations of 50,000 or fewer residents.[17] Additionally, most Federal agencies and demographic experts have determined that densely populated areas with 50,000 or more inhabitants are urbanized areas. For this reason, investments authorized under the proposed rule would allow System institutions to invest in areas with populations of less than 50,000 residents based on the latest decennial census of the United States.

By allowing the System to invest in rural communities that have fewer than 50,000 residents, the proposed rule provides "an adequate and flexible flow of funds into rural areas" in accordance with the Act, while precluding System institutions from investing in urbanized areas. Information is publicly available on the Census Bureau’s Web site, including census population statistics and maps. As a result, System institutions and other interested parties are able to determine if a particular location is within a "rural" community for the purposes of § 615.5176(a).

B. Debt Securities

Proposed § 615.5176(b) would authorize System institutions to invest in rural communities by purchasing and holding debt securities for purposes specified in § 615.5176(b)(1) through (5). The proposed rule defines debt securities as obligations that are commonly recognized in capital markets as a medium for investment, including government obligations, corporate bonds, revenue bonds, asset-backed securities and mortgage securities. Proposed § 615.5176(b) expressly excludes commercial loans and instruments or transactions that are more similar to commercial loans than to traditional investment instruments in order to clarify the statutory distinction between loans and investments. Under the proposed rule, System institutions could not use their authority to invest in rural communities to make loans to otherwise ineligible borrowers.

1. Essential Community Facilities

Proposed § 615.5176(b)(1) would authorize System institutions to invest in debt securities that finance essential community facilities, such as hospitals, health care facilities, emergency services, and schools. Many essential community facilities are owned and operated by State, local, or municipal governments. In other cases, quasi-governmental or highly regulated private and nonprofit entities own and operate essential community facilities. Government obligations and revenue bonds often fund the construction and renovation of these facilities. Rural communities are currently facing increasing difficulty in funding these facilities because of deteriorating liquidity in financial markets. System institutions can help alleviate this problem by purchasing and holding debt securities as investments in community facilities that provide essential services to rural residents.

2. Basic Transportation Infrastructure

Financing basic transportation infrastructure, such as roads, bridges, and other public transportation systems, is another authorized investment purpose under the proposed rule. The public sector owns, maintains, and operates most basic transportation infrastructure in the United States. Most rural transportation facilities are operated by public agencies or nonprofit groups, with a small percentage operated by private entities. Transportation projects are another area where the System could significantly help rural communities build and improve infrastructure, which would strengthen their economic viability. Rural communities and particularly agricultural industries, depend on quality transportation systems, which are critical in supplying inputs, shipping and distributing outputs and products, and supporting economic development. Proposed § 615.5176(b)(2) would authorize System institutions to purchase government obligations, revenue bonds, and other debt obligations that support basic transportation infrastructure.

3. Revitalization of Rural Communities After a Disaster

Proposed § 615.5176(b)(3) would permit System institutions to purchase debt securities in revitalization projects that help rebuild rural areas devastated by disasters where an emergency has been declared pursuant to law. These investments must support local efforts and residents by contributing to the economic recovery of the affected rural community.

4. Rural Development Projects with Government Sponsorship or Guarantees

Under proposed § 615.5176(b)(4), System institutions could invest in debt securities that a government issues, sponsors, or guarantees under programs to fund rural community development projects. Without crucial financial support from Federal, State, or local governments, rural communities would face greater difficulty in funding vital development projects. By investing in debt securities for rural economic development under government programs, the System assists rural communities across America in accordance with its statutory mandate. By proposing § 615.5176(b)(4), the FCA is encouraging System institutions to work with Federal, State, and local governments and their partners to invest in projects that bring jobs, infrastructure, community facilities, and vital services to rural areas and their residents.

Proposed § 615.5176(b)(4)(i) covers debt securities that the United States and its agencies issue, sponsor, or guarantee under programs that have the specific purpose of directly financing economic development in rural communities. The FCA emphasizes that the proposed rule does not require the full faith and credit of the United States for bonds issued or guaranteed by agencies of the United States. However, these investments are authorized only if the Federal agency issues or guarantees these bonds or obligations in accordance with a program that has the specific purpose of promoting economic development in rural areas. For example, the Tennessee Valley Authority, the Small Business Administration, and various agencies in the USDA and the Department of Housing and Urban Development issue and guarantee bonds under specific programs for infrastructure, facilities, and other development projects in rural areas, and System investment in these obligations would be authorized by the proposed rule.

Other Federal agencies operate programs in both metropolitan and rural areas which are not part of any specific rural development mission. Bonds and other obligations issued or guaranteed under such programs would not qualify as investments under the proposed rule. For example, the proposed rule would not authorize the FCS to invest in mortgage securities issued or guaranteed by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation because the purpose of these securities is to enhance the liquidity of residential home loans throughout the United States, rather than to promote rural development. Another regulation, § 615.5140, permits System institutions to make investments for liquidity and risk-management purposes in bonds and obligations, including residential mortgage securities, that Federal agencies issue or guarantee under programs that are unrelated to rural development. The proposed rule focuses on investments in rural communities and would not authorize System institutions to hold residential mortgage securities issued by other GSEs, but the FCA continues to study this issue.

Proposed § 615.5176(b)(4)(ii) would allow System institutions to invest in debt securities that any State, the Commonwealth of Puerto Rico, a local or municipal government, or other political subdivision of a State, issues, sponsors, or guarantees that are specifically related to development in rural communities. Many local or municipal governments and other political subdivisions, such as special districts, often sponsor particular rural development projects by providing tax incentives or other benefits to private-sector obligors who issue revenue bonds. These revenue bonds, which help finance rural development projects, would qualify as investments that FCS institutions could purchase and hold under proposed § 615.5176(b)(4)(ii). This provision would also allow System institutions to invest in mortgage securities that are issued or guaranteed by State or local agencies that specialize in rural development.

5. Rural Development Projects Financed by Non-System Financial Institutions

Proposed § 615.5176(b)(5) would allow System institutions to invest in debt securities issued by non-System financial institutions. The proposed rule would authorize System institutions to purchase these debt securities to increase financial assistance to rural communities and improve the liquidity of rural financial markets. This provision would enhance cooperation between System and non-System financial institutions and ultimately benefit rural communities. System institutions may purchase asset-backed securities, covered bonds, or similar types of bonds issued by non-System financial institutions directly or through trusts that supply funds to non-System financial institutions for rural development. Investments made under the pilot programs evidence that securities, including commercial bank bonds issued by rural community banks and purchased by System institutions, can effectively increase bank liquidity. These investments benefit rural communities and residents, while establishing partnerships between non-System and System institutions.

C. Equity Investments

Equity investments in venture capital funds are another type of investment that the proposed rule would authorize FCS institutions to purchase and hold. Under this provision of the proposed rule, System institutions could invest in venture capital funds that provide capital to start-up and small private-sector enterprises that bring jobs and economic opportunities to rural communities. Venture capital funds that operate in the United States invest only 1.6 percent of their funds in rural community enterprises, although these enterprises represent 19.2 percent of all businesses.[18] System institutions could make a small, but meaningful, contribution to rural economic development by investing in venture capital funds that provide capital into rural enterprises. As discussed in greater detail below, System institutions would hold only small, passive investment positions in venture capital funds because of statutory and regulatory restrictions.

Proposed § 615.5176(c) would authorize System institutions to make equity investments in two types of entities, RBICs and venture capital funds, for the purpose of providing equity capital to rural business enterprises. Rural entrepreneurs often lack sufficient equity capital to establish and expand businesses that are the mainstay of prosperous rural economies. Venture capital funds provide equity capital in rural business enterprises, which promote economic development and job opportunities in rural communities.

1. Rural Business Investment Companies

Proposed § 615.5176(c)(1) would authorize System institutions to purchase and hold equity investments in RBICs that are established and operate in accordance with 7 U.S.C. 2009cc et seq. As discussed earlier, the Farm Security and Rural Investment Act of 2002 created the Rural Business Investment Program and expressly authorized any Farm Credit System institution to establish and invest in RBICs. Congress intended to promote economic development, create wealth, and expand job opportunities in rural areas through RBIC equity investments. The System's statutory authority to establish and invest in RBICs is incorporated into proposed § 615.5176(c)(1). The proposed rule would enable System institutions to invest in RBICs to the fullest extent allowed by 7 U.S.C. 2009cc et seq. The FCA emphasizes that proposed § 615.5176(c)(1) would authorize System institutions to invest in both leveraged and non-leveraged RBICs.

2. Venture Capital Funds

Proposed § 615.5176(c)(2) would authorize System institutions to invest in venture capital funds which, in turn, invest in rural businesses that provide job opportunities. Under this provision, System institutions would be able to indirectly provide rural entrepreneurs needed equity capital through venture capital funds, such as regional investor networks, which have investment objectives similar to RBICs.

The Center for the Study of Rural America of the Federal Reserve Bank of Kansas identified a significant need for equity capital for rural entrepreneurs because entrepreneurial activity is strongly linked to economic growth.[19] For this reason, experts conclude that additional focus on rural entrepreneurship can be an effective strategy in combating the decline of traditional resource-based businesses in rural areas.[20] However, rural economies have difficulty attracting venture capital because metropolitan areas usually offer better profits. Policy officials and experts agree that entrepreneurship in remote and sparsely populated rural areas can be challenging because access to skilled labor, technology, and capital is more limited. Investments in venture capital funds that focus on rural entrepreneurs can effectively begin to overcome these barriers to rural businesses.

Proposed § 615.5176(c)(2) would place specific restrictions on System investment in venture capital funds to ensure that these investments remain small and passive. Additionally, these controls would minimize potential financial risk to the System institutions, while providing the System with flexibility to invest in rural development under the Act.

Proposed § 615.5176(c)(2)(i) would control financial risk by prohibiting any System institution from investing more than 5 percent of its total surplus in venture capital funds and more than 2 percent of its total surplus in any one venture capital fund. The FCA emphasizes that this limit on venture capital funds in proposed § 615.5176(c)(2)(i) is in addition to the overall limit in proposed § 615.5176(e)(i), which prevents total rural community investments at any FCS institution from exceeding 150 percent of its total surplus.

The restrictions in proposed § 615.5176(c)(2)(ii) and (iii) would prevent System institutions from controlling and managing venture capital funds. Proposed § 615.5176(c)(2)(ii) would prohibit any FCS institution from holding more than 20 percent of the voting equity of any venture capital fund. The purpose of this provision is to allow System institutions to invest in venture capital funds that focus on rural areas, while imposing a reasonable limit that prevents any System institution from gaining a controlling interest in any fund. Proposed § 615.5176(c)(2)(iii) would prohibit any FCS institution from participating in the routine management or operation of a venture capital fund.

Finally, proposed § 615.5176(c)(2)(iv) and (v) would establish controls to avoid potential conflicts of interest. Proposed § 615.5176(c)(2)(iv) would prohibit any director, officer, or employee of a System institution from serving as a director, officer, employee, principal shareholder, or trustee of any venture capital fund or of any entity funded by, or affiliated with, the venture capital fund. Proposed § 615.5176(c)(2)(v) would prohibit any System institution from participating in any decision or action of a venture capital fund involving or affecting any customer of the institution. Although proposed § 615.5176(c)(2)(v) would permit a System institution to invest in venture capital funds that hold equity in one of its borrowers, the institution could not participate in decisions or actions that affect such customers. Additionally, the proposed rule does not prohibit System institution directors, officers, or employees from serving in an investment screening or other advisory capacity to a venture capital fund, subject to the restrictions discussed above. System institution representatives serving in an advisory capacity to a venture capital fund also remain subject to FCA conflict of interest regulations and institution policies.

D. Other Investments Approved by the Farm Credit Administration

The FCA's experience with the pilot programs reveals that the types of System investments may change as the needs of rural communities evolve. For this reason, the FCA believes that the new regulation should contain a mechanism for approving investments that currently do not exist, but may emerge in the future. Currently, § 615.5140(e) provides the FCA with the authority to approve new investments that are not specifically authorized by regulation.

Proposed § 615.5176(d) establishes specific criteria for System institutions to apply to the FCA for permission to hold investments that are not expressly authorized by this regulation. Under this proposal, written requests by System institutions would: (1) Describe the proposed project or program in detail; (2) explain its risk characteristics; and (3) demonstrate how such investments are consistent with the System's statutory mandate to serve agriculture and rural communities. In approving such requests, the FCA may impose additional or more stringent conditions than the requirements of this regulation to ensure safety and soundness or compliance with law.

E. Restrictions on Rural Community Investments

Other requirements governing System investments in rural communities are covered by proposed § 615.5176(e). These requirements either pertain to safety and soundness or implement statutory requirements.

1. Portfolio Limit

Proposed § 615.5176(e)(1) would authorize each System bank, association, or service corporation to make rural community investments in an amount not to exceed 150 percent of the institution's total surplus. The proposed portfolio limit on rural community investments ensures that lending to farmers, ranchers, aquatic producers, cooperatives, and other borrowers that own the FCS remains the primary activity of System institutions. At the same time, the proposed limit provides the FCS with the flexibility to make investments in an amount that offers meaningful assistance to rural communities and their residents. This limit on rural community investments is compatible with limits that the Act and other FCA regulations impose on System activities that are related to the System's mission.

Based on financial information reported as of December 31, 2007, the proposed limit would authorize the System to invest up to a total of $35.8 billion in rural community investments.[21] For example, this would permit an FCS association with $1.0 billion in assets and $150.0 million in total surplus to invest up to $225.0 million in rural communities.

The FCA considered the following factors when it decided to propose 150 percent of total surplus as the portfolio limit: (1) The safety and soundness of FCS institutions; (2) the significant needs of rural communities; (3) the FCS's ability and capacity to assist rural communities, and (4) the ability of FCS institutions to fulfill mission objectives. Total surplus provides a basis for each institution's risk tolerance level, and the FCA has historically used this standard to limit System investments in unrated obligations that are less liquid. System institutions also use limits based on similar capital measures to ensure that asset and portfolio concentrations are safely and soundly managed.

This proposed limit also is based on the limits established for the pilot programs. The FCA established individual institution limits equal to 100 percent of total surplus (or in some cases 10 percent of total loans) for investments held under specific pilot programs, and 150 percent of total surplus for an institution's portfolio of all rural community investments. The pilot programs evidence that System institutions exercised caution when making investments in rural communities. Institutions have not approached the portfolio limit. Although the proposed rule establishes an upper regulatory portfolio limit, the FCA expects that each System institution would determine an appropriate internal portfolio limit based on the individual institution's objectives, capital position, risk tolerance, and other factors that it considers appropriate, in accordance with § 615.5133(c).

The FCA also considered the System's need to establish a program of sufficient size that could adequately deliver benefits to rural communities while balancing operational efficiency needs. In establishing the portfolio limit, the FCA sought to ensure that each System institution, large or small, could effectively partner with government agencies and non-System financial institutions in projects that may positively affect their local rural communities.

The current credit crisis emphasizes the importance of funding for rural development projects and enhancing the liquidity of rural credit markets. The portfolio limit curtails the maximum risk exposure of System institutions, and it also encourages partnerships with non-System financial institutions and government agencies that are active in rural development. Collaboration between System institutions and larger, more established financial investors is a way to help rural communities access financing for vital projects, especially during times of economic uncertainty.

2. <u>Obligor Limit</u>

Proposed § 615.5176(e)(2) would establish an obligor limit for investments in rural communities. This provision would not allow any System institution to invest more than 15 percent of its total surplus in investments issued by a single entity, issuer, or obligor. However, the obligor limit would not apply to obligations issued or guaranteed on the full faith and credit of the United States, its agencies, instrumentalities, or corporations. In the event only a portion of the obligation is guaranteed, the non-guaranteed portion of the obligation would remain subject to the obligor limit.

This obligor limit is designed to control undue credit risk from a single counterparty on the capital of any System institution and provide sufficient diversification of an institution's rural community investment portfolio. For safety and soundness reasons, the FCA decided that the obligor limit for rural community investments should be lower than the 20 percent of total capital obligor limit established for investments held by System institutions to maintain liquidity and manage market risks in § 615.5140(d). In contrast to the liquid and marketable securities held under § 615.5140, rural community investments are often unrated and, therefore, capital markets would consider them less liquid. The FCA anticipates that most rural community investments would be held to maturity and would not trade. For these reasons, the FCA proposes an obligor limit for rural community investments that does not exceed 15 percent of the total surplus of each System institution.

This regulatory provision would also require a System institution to count securities that it holds through an investment company towards this 15-percent obligor limit to prevent undue risk concentrations. This provision provides an exception when the investment company's holding of the security of any one issuer does not exceed 5 percent of the investment company's total portfolio. The FCA patterned this provision after § 615.5140(d)(2), which applies to investments that FCS institutions hold through investment companies for the purposes of maintaining liquidity or managing market risks.

The FCA emphasizes that proposed § 615.5176(e)(2) establishes a maximum obligor limit for rural community investments. The FCA expects every Farm Credit institution to establish internal obligor limits based on its financial condition and the size and complexity of securities that it contemplates buying and holding. The obligor limit that each System institution sets should be based on both identified risks and its own risk-bearing capacity.

3. Maturities for Debt Securities in Rural Communities

Proposed § 615.5176(e)(3) would require most rural community investments to mature in no more than 20 years. However, debt securities may mature in not more than 40 years if the United States or its agencies provide a guarantee or a conditional commitment of guarantee for 50 percent or more of the total issuance or obligation. Proposed § 615.5176(e)(3) establishes terms to maturity that are flexible enough to accommodate typical rural development projects that this rule would authorize. This regulatory approach would enable System institutions to participate in USDA and other State rural development programs that provide a supplemental or partial guarantee, which contributes to, or enhances, whole-project financing. Also, investments that fund essential rural community facilities, such as hospitals, police and fire stations, and other emergency service facilities, typically require project financing over longer terms to maturity.

4. Exclusion from the Liquidity Reserve

Proposed § 615.5176(e)(4) would require System banks to exclude rural community investments from their liquidity reserve under § 615.5134 of this part. System banks may purchase and hold the eligible investments listed in
§ 615.5140 to maintain liquidity reserves, manage interest rate risk, and invest surplus short-term funds in accordance with § 615.5132. Only investments that can be promptly converted into cash without significant loss are suitable for achieving these objectives. Rural community investments are not suitable for liquidity purposes or market risk management because these investments do not typically carry ratings assigned by a Nationally Recognized Statistical Rating Organization and are not actively traded in the established secondary markets.

5. Association Investments

Proposed § 615.5176(e)(5) would implement sections 2.2(10) and 2.12(18)[22] of the Act, which require each funding bank to supervise and approve the investment activities of its affiliated associations. System banks may discharge their statutory and regulatory responsibility to approve and supervise an association's rural community investments through covenants in the general financing agreement, policies, or other appropriate formats. System banks may also provide advisory, analytical, and research services that help their affiliated associations to devise strategies for investing in rural communities and managing these assets.

6. Attribution of Service Corporation Investments

Proposed § 615.5176(e)(6) would require System service corporations to attribute all rural community investments to their System institution parents based on the ownership percentage of each bank or association. This provision would prevent FCS institutions from utilizing service corporations to exceed the regulatory limits on rural community investments.

F. Management of Rural Community Investments

Proposed § 615.5176(f) addresses rural community investment management practices at FCS institutions and ensures that System institutions invest in rural communities in a safe and sound manner. If a Farm Credit System institution chooses to invest in rural communities, proposed § 615.5176(f) would require its board of directors to first adopt written policies for managing the institution's investments. These investment management policies must be appropriate for the levels, types, and complexities of each institution's rural community investments. Proposed § 615.5176(f) would also require the board of directors ensure the institution's implementation of procedures and internal controls that ensure compliance with the board's policies and the regulation.

Additionally, proposed § 615.5176(f) would require these written policies to comply with § 615.5133, which governs management practices for investments held for liquidity and risk management. Although rural community investments differ from liquid investments, strong and disciplined investment management practices are essential to the safety and soundness of all investment activities within System institutions. As a result, sound investment management practices prescribed by § 615.5133 are also applicable to rural community investments and, for this reason, the FCA is extending § 615.5133 to rural community investments.

Existing § 615.5133 requires a System institution's investment management policies to address risk tolerance, delegations of authority, internal controls, securities valuation, and reporting to the board. Also, § 615.5133 requires that investment policies be appropriate for the size, type, and risk characteristics of the institution's investments. The FCA expects each System institution to fully and carefully evaluate its risk tolerance in accordance with § 615.5133(c) when it considers purchasing any rural community investments. Finally, proposed § 615.5176(f) expressly exempts those rural community investments that System institutions classify and account for as held-to-maturity under generally accepted accounting principles from the securities valuation requirement in § 615.5133(f). This exemption is based on the different accounting classifications for these securities.

G. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

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[1] 12 U.S.C. 2013(15) and 2122(13)(A).

[2] 12 U.S.C. 2073(10) and 2093(18).

[3]12 U.S.C. 2211. Section 4.25 authorizes System banks to organize service corporations. Section 4.28A of the Act, 12 U.S.C. 2214a, confers this authority on System associations.

[4]Section 4.25 of the Act prohibits service corporations from extending credit or providing insurance services to System borrowers. Otherwise, the Act authorizes service corporations to perform any other function or service that its FCS parents may perform. Service corporations currently have authority to purchase and hold other investments under FCA regulations in subpart E of part 615.

[5]Pub. L. No. 107-171, § 384J, 116 Stat. 134, 397 (May 13, 2002).

[6]The farmers' note program authorizes production credit associations and agricultural credit associations to invest in notes, contracts, and other obligations farmers and ranchers enter into with cooperatives and dealers that sell farm equipment, inputs, and supplies. Farmers' notes are investments that provide liquidity to small rural agribusinesses.

[7]Carol A. Jones, et al., "Population Dynamics Are Changing the Profile of Rural Areas," Amber Waves, Economic Research Service, United States Department of Agriculture, April 2007, p. 5.

[8]"Rural Education At A Glance," Rural Development Research Report Number 98, Economic Research Service, United States Department of Agriculture, November 2003, p. 4.

[9]Walter Gregg, The Availability and Use of Capital by Critical Access Hospitals, Flex Monitoring Team Briefing Paper No. 4, Flex Monitoring Team – University of Minnesota, University of North Carolina at Chapel Hill, and the University of Southern Maine, March 2005, p. 10.

[10]Ibid., p. 25 and 26.

[11]Ted Covey, et al., "Agricultural Income and Finance Outlook," Outlook, AIS-85, Economic Research Service, United States Department of Agriculture, December 2007, p. 49.

[12] "Chapter 3-Focus on Agriculture," Worker Health Chartbook 2004, National Institute for Occupational Safety and Health, NIOSH Publication No. 2004-146, p. 1.

[13]Sections 1.5(21), 2.2(20), 2.12(20) and 3.1(16) of the Farm Credit Act (12 U.S.C. 2013(21), 2073(20), 2093(20), 2122(16)).

[14]The United States Census Bureau defines an urbanized area as an urban area of 50,000 or more people that have core census block groups or blocks that have a population density of at least 1,000 people per square mile and surrounding census blocks that have an overall density of at least 500 people per square mile.

[15]Andrew F. Coburn et al., "Choosing Rural Definitions: Implications for Health Policy," Rural Policy Research Institute Health Panel, March 2007, p. 1.

[16]Ibid.

[17]According to section 3.7(f) of the Act, 12 U.S.C. 2128(f), banks for cooperatives and agricultural credit

banks may extend credit to water and waste disposal facilities in communities where the population does not exceed 20,000 inhabitants based on the latest decennial census of the United States. A provision of the Farm Security and Rural Investment Act of 2002, 7 U.S.C. 2009cc, et seq., authorizes System institutions to establish and invest in rural business investment companies in communities in non-metropolitan counties that have populations of 50,000 or less inhabitants under the last decennial census of the Unites States.

[18]Kendall McDaniel, "Venturing into Rural America," The Main Street Economist, Center for the Study of Rural America – Federal Reserve Bank of Kansas City, p. 2.

[19]Mark Drabenstott, et al., "Main Streets of Tomorrow: Growing and Financing Rural Entrepreneurs - A Conference Summary," Economic Review, Third Quarter 2003, Federal Reserve Bank of Kansas City, p. 73 and 74.

[20]Ibid.

[21]This amount is comparable to the regulatory limits established for the System's rural home lending and investments in farmers' notes activities, which are limited to amounts totaling $35.9 billion for each program as of year-end, although actual amounts outstanding under these programs represented 1.3 percent and less than 1 percent of total outstanding loans, respectively.

[22]12 U.S.C. 2073(10) and 2093(18).

List of Subjects in 12 CFR Part 615

Accounting, Agriculture, Banks, banking, Government securities, Investments, Rural areas.

For the reasons stated in the preamble, part 615 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 615--FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

1. The authority citation for part 615 is revised to read as follows:

Authority: Secs. 1.1, 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2001, 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b-6, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-7, 2279aa-8, 2279aa-10, 2279aa-12); 7 U.S.C 2009cc et seq.; sec. 301(a) of Pub. L. 100-233, 101 Stat. 1568, 1608.

Subpart F--Property, Transfers of Capital and Other Investments

2. A new § 615.5176 is added to subpart F to read as follows:

§ 615.5176 Rural community investments.

(a) *Rural communities.* As authorized by this section, each Farm Credit System (System) bank, association, or service corporation (hereafter "institution") may make rural community investments. All investments that any System institution makes under this section in rural communities must be outside an urbanized area as determined by the latest decennial census of the United States.

(b) *Debt securities.* Each institution may make investments in rural communities by purchasing and holding debt securities. For the purposes of this section, debt securities are obligations that are commonly recognized in the established capital markets as a medium for investment. Debt securities exclude commercial loans and any instrument or transaction that is more similar to a commercial loan than to a traditional investment instrument or transaction. Debt securities include government obligations, corporate debt obligations, revenue bonds, asset-backed securities, as defined by § 615.5131(a), and mortgage securities, as defined by § 615.5131(h). Debt securities that institutions purchase and hold under this section must provide funding in rural communities for:

(1) Essential community facilities such as hospitals, clinics, emergency services, and schools;

(2) Basic transportation infrastructure, such as roads, bridges, and other public transportation systems;

(3) Revitalization projects that rebuild rural areas recovering from disasters where an emergency has been declared pursuant to law;

(4) Rural development projects for which the issuer, sponsor, or provider of a guarantee is:

(i) The United States or any of its agencies, instrumentalities, or corporations, under programs that have the specific purpose of directly financing economic development in rural areas; or

(ii) Any State, the Commonwealth of Puerto Rico, local or municipal governments, or other political subdivisions.

(5) Non-System financial institutions for their activities that support rural development.

(c) *Equity investments.* System institutions may also make investments in:

(1) *Rural Business Investment Companies* that are established and operate in accordance with 7

U.S.C. 2009cc et seq.; or

(2) *Venture capital funds* that are established to promote economic development and job opportunities in businesses located in rural communities, so long as an institution does not:

(i) Invest more than 5 percent of its total surplus in venture capital funds and more than 2 percent of its total surplus in any one venture capital fund;

(ii) Hold more than 20 percent of the voting equity of any one venture capital fund;

(iii) Participate in the routine management or operation of any venture capital fund;

(iv) Allow any institution director, officer, or employee to serve as director, officer, employee, principal shareholder, or trustee of any venture capital fund, or of any entity funded by, or affiliated with any venture capital fund; or

(v) Participate in any decision or action of any venture capital fund involving or affecting any customer of the institution.

(d) *Other investments approved by the Farm Credit Administration*. System institutions may make other investments in rural communities that are not expressly authorized by this section if they are approved by the Farm Credit Administration. Written requests for Farm Credit Administration approval must describe the proposed project or program in detail, explain its risk characteristics, and demonstrate how such investments are consistent with the statutory mandate of the Farm Credit System.

(e) *Restrictions on rural community investments*.

(1) *Portfolio limit*. An institution must not invest more than 150 percent of its total surplus in rural community investments.

(2) *Obligor limit*. An institution must not invest more than 15 percent of its total surplus in rural community investments issued by any single entity, issuer, or obligor. This obligor limit does not apply to obligations of the United States or its agencies, instrumentalities, or corporations. An institution must count securities that it holds through an investment company towards the obligor limit of this section unless the investment company's holding of the securities of any one issuer does not exceed 5 percent of the investment company's total portfolio.

(3) *Maturities for debt securities*. Debt securities purchased by institutions under this section must mature in not more than 20 years, except that debt securities may mature in not more than 40 years if the United States or its agencies provide a guarantee or a conditional commitment of guarantee for 50 percent or more of the total issuance or obligation.

(4) *Exclusion from the liquidity reserve*. No Farm Credit bank shall include any investment made in accordance with this section in its liquidity reserve under § 615.5134 of this part.

(5) *Association investments*. A System association may hold rural community investments only with the approval of its funding bank. Each district Farm Credit bank must annually review all rural community investments held by its affiliated associations.

(6) *Attribution of service corporation investments*. All investments in rural communities that service corporations hold under this section must be attributed to their System institution parents based on the ownership percentage of each bank or association.

(f) *Management of rural community investments*. Before a System institution invests in rural communities, its board of directors must first adopt written policies for managing the institution's rural community investments. Investment management policies must be appropriate for the levels, types, and complexities of each institution's rural community investments. These written policies must comply with requirements of § 615.5133. Investments made under this section that System institutions classify and account for as held-to-maturity securities in accordance with generally accepted accounting principles are exempt from the requirements of paragraph (f) of § 615.5133. The board of directors must ensure that the institution implements procedures and internal controls to ensure compliance with the board’s policies and the regulation.

Dated: June 10, 2008

Roland Smith,
Secretary,
Farm Credit Administration Board.

73 FR 35361, 06/23/2008

Handbook Mailing HM-08-6

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Chapter VI

RIN 3052-AC39

Statement on Regulatory Burden

AGENCY: Farm Credit Administration.

ACTION: Notice of intent; request for comment.

SUMMARY: The Farm Credit Administration (FCA, our, or we) is issuing a notice of regulatory review and request for comment. The FCA will review its regulations to consider whether existing regulations are inefficient or burdensome. The FCA is seeking public comment on the appropriateness of the requirements it imposes on the Farm Credit System (System). We ask for comments on our regulations that may duplicate other requirements, are ineffective, or impose burdens that are greater than the benefits received. We are taking this action to improve the regulatory framework within which System institutions operate.

DATES: Please send your comments to the FCA by August 22, 2008.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site or the Federal eRulemaking Web site. As faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, please consider another means to submit your comment if possible. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.
- FAX: (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Jacqui Melvin, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4268, TTY (703) 883-4434,

or

Mary Alice Donner, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objective

The objective of this notice is to continue our comprehensive review of regulations governing the System and to eliminate, consistent with law, safety, and soundness, all regulations that are unnecessary, unduly burdensome or costly, or not based on the law. We are requesting public comment to identify FCA regulations that:

- May duplicate other requirements;
- Are ineffective; or
- Impose burdens that are greater than the benefits received.

To accomplish our objective, we are targeting particular regulations for a more focused and in-depth review.

II. Background

The FCA is the independent Federal agency in the executive branch of the Government responsible for examining and regulating System institutions. As a Government-sponsored enterprise, the System primarily provides loans to farmers, ranchers, aquatic producers and harvesters, agricultural cooperatives, and rural utilities.

III. Regulations under Review

The regulations of FCA that are subject to regulatory review described in this notice are codified in title 12, chapter VI, of the Code of Federal Regulations. In our previous notices, we asked the public to comment on all of our regulations, and we were able to accomplish our objective of reducing regulatory burden. In this notice, we would like the public to comment specifically on these targeted regulations:

(1) Part 607 – Assessment and Apportionment of Administrative Expenses;
(2) Part 614 – Loan Policies and Operations;
(3) Part 616 – Leasing;
(4) Part 617 – Borrower Rights;
(5) Part 618 – General Provisions; and
(6) Part 626 – Nondiscrimination in Lending.

IV. Requesting Comments

Your comments are appreciated and will assist us in our continuing efforts to identify and reduce regulatory burden on System institutions. We will also continue our efforts to maintain and adopt regulations and policies that are necessary to implement the Farm Credit Act of 1971, as amended, and ensure the safety and soundness of the System. These actions will enable the System to better serve America's farmers, ranchers, aquatic producers and harvesters, agricultural cooperatives, and rural utilities in changing agricultural credit markets.

Dated: June 17, 2008

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

73 FR 65567, 11/04/2008

Handbook Mailing HM-08-7

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Chapter VI

RIN 3052-AC42 and 3052-AC39

Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Mission-Related Investments, Rural Community Investments; Regulatory Burden

AGENCY: Farm Credit Administration.

ACTION: Proposed rule and notice of intent; public comment notification.

SUMMARY: In June of 2008, the Farm Credit Administration (FCA, we, or us) published in the Federal Register a proposed rule pertaining to investments in rural communities as well as a notice of intent pertaining to regulatory burden, both requesting comments from the public. For both, a total of five comments sent via the www.regulations.gov eRulemaking portal were not transmitted to the FCA. We are asking any member of the public who used this method to send comments to FCA and believes their comment may have been lost to contact the staff members listed below.

DATES: Please contact us on or before November 21, 2008.

ADDRESSES: You may review copies of comments we received on these two documents at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments."

FOR FURTHER INFORMATION CONTACT:

Dale L. Aultman, Senior Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434;

or

Mary Alice Donner, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION: On June 16, 2008, we published (73 FR 33931) a proposed rule that would authorize each Farm Credit System bank, association, and service corporation to invest in rural communities across America under certain conditions. The comment period for this proposed rule ended on August 15. On June 23, 2008, we published (73 FR 35361) a notice of regulatory review and request for comment pertaining to regulatory burden. That comment period ended on

August 22, 2008. However, due to a technical software error that is now corrected, a total of five public comments submitted via the www.regulations.gov eRulemaking portal were not transmitted to FCA. Four comments pertained to the proposed rule on rural community investments and one comment pertained to the regulatory burden notice.

The FCA supports public involvement and participation in its regulatory process. Therefore, we would like any member of the public who submitted a comment, via the eRulemaking portal, and believes their comment may have been lost to contact us so we may personally ensure that your comment is included. You may contact us by calling one of the two individuals listed in the "“For Further Information Contract"” section of this notice.

Dated: October 30, 2008

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

73 FR 70921, 11/24/2008

Handbook Mailing HM-08-8

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 619, 620, 621

RIN 3052-AC35

Definitions; Disclosure to Shareholders; Accounting and Reporting Requirements; Disclosure and Accounting Requirements

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is proposing to amend and/or make revisions and technical changes to our regulations. These amendments are proposed to clarify FCA's regulations related to disclosure and reporting practices of Farm Credit System (System) institutions. In addition, they will ensure that FCA regulations are consistent with System structural changes and are updated to include changes to accounting and reporting standards.

DATES: You may send comments on or before January 23, 2009.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Thomas R. Risdal, Senior Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Robert Taylor, Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Clarify the FCA regulations related to disclosure and reporting practices of System institutions; and
- Ensure that FCA regulations are consistent with System structural changes and updated to include changes to accounting and reporting standards.

II. Background

The Farm Credit Amendments Act of 1985 (1985 Amendments)[1] added provisions to the Farm Credit Act of 1971, as amended (Act),[2] requiring FCA to regulate the disclosure and reporting practices of System institutions. The Act, as amended by the 1985 Amendments, requires: (1) Each System institution to prepare and publish annual financial reports as prescribed by the FCA; and (2) that the annual reports contain financial statements prepared in accordance with generally accepted accounting principles (GAAP) and be audited by an independent public accountant. To implement these requirements, we issued regulations at part 620 (Disclosure to Shareholders) and part 621 (Accounting and Reporting Requirements). The regulations established the requirements for the preparation of financial reports by Farm Credit banks and associations, including annual reports to shareholders and reports of condition and performance (Call Reports). The regulations also established requirements for categorizing and maintaining information on high-risk loans and a requirement that each System institution have its financial statements audited by a qualified public accountant. When developing the regulations at parts 620 and 621, we considered the Securities and Exchange Commission's (SEC) disclosure and reporting requirements for public companies in effect at the time, as well as the requirements of other financial institution regulators. We adapted these requirements to the cooperative structure of System institutions.

Since our adoption of the regulations at parts 620 and 621, they have been revised several times to address a variety of issues. Most recently, we revised the regulations to incorporate improvements in governance and financial reporting best practices brought about by the Sarbanes-Oxley Act of 2002[3] and the SEC's implementing regulations. While there have been a number of amendments to FCA's regulations over the years, the primary disclosure requirements for shareholder reports, Call Reports and nonperforming loans have not changed significantly since they were adopted in the 1980s. However, System structure has changed as have certain accounting and reporting standards. In order to incorporate these changes into FCA's regulations, as applicable, we propose the following amendments to parts 619, 620, and 621.

III. Section-by-Section Analysis

A. Generally Accepted Auditing Standards [§§ 619.9270(e) and 621.2(d)]

The Public Company Accounting Oversight Board (PCAOB) was created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies[4] in the preparation of informative, fair, and independent audit reports. As a result of its creation, public institutions are required to follow the auditing standards that are established by the PCAOB, while nonpublic institutions may continue to follow the standards that are established by the American Institute of Certified Public Accountants (AICPA). We propose to revise the definition of generally accepted auditing standards in § 621.2(d) to include reference to the standards and guidelines that are generally accepted in the United States of America and that are adopted by the authoritative body that governs the overall quality of the audit performance. Specifically, we propose to remove the language referring to the AICPA, and insert in its place a reference solely to generally accepted auditing standards. Additionally, to ensure consistency throughout the regulations, we propose to amend § 619.9270(e) to remove the language referring to the AICPA, and insert in its place a reference to the authoritative body governing overall audit quality.

B. Signatures on Financial Reports [§ 620.3(b)(3)]

Section 620.3(b) and (c) provide the requirements for signing and certifying the financial accuracy of the reports[5] by the institution's chief executive officer (CEO), chief financial officer (CFO), and a designated board member. Existing § 620.3(b)(3) provides that the designated board member that signs and certifies the reports is the board member that certifies reports of condition and performance. The language "reports of condition and performance" is a direct reference to the Call Report requirements in part 621, Accounting and Reporting Requirements, which is an incorrect reference. Thus, we propose to amend § 620.3(b)(3) to remove the reference to reports of condition and performance.

C. Contents of the Annual Report to Shareholders; Incorporation by Reference [§ 620.5(a) through (e)]

Section 620.5(a) through (e) requires that an institution's annual report contain: (1) A description of its business; (2) a description of its property; (3) disclosure of certain legal proceedings and enforcement actions to which the institution is a party; (4) a description of its capital structure, and (5) a description of its liabilities. In addition, § 620.5(g) requires an institution's annual report to contain a management's discussion and analysis (MD&A) section that must include information necessary to an understanding of the institution's financial condition, material changes thereto, and results of operations. In certain circumstances, it may be appropriate for the institution to include the disclosures required by § 620.5(a) through (e) in the MD&A section of the annual report. In order to provide institutions flexibility in meeting the above requirements and to avoid the occurrence of duplicate disclosures, we propose to amend § 620.5(a) through (e) to allow the information required by these provisions to be incorporated by reference to the MD&A section, so long as the descriptions and disclosures are appropriately included in the MD&A as required by § 620.5(g).

D. Description of Business; Significant Developments [§ 620.5(a)(4)]

Section 620.5(a)(4) requires disclosure of any significant developments within the last 5 years that could have a material impact on earnings or the interest rates to borrowers. We are adding patronage and dividends to the list for which disclosure of significant developments that have material impact is required. Since an institution's patronage and patronage policies and practices ultimately affect the patronage or dividend return to a patron/stockholder, we propose to further amend this section to specifically require that changes to an institution's patronage and dividend policies and practices be disclosed if the changes are considered a significant development in accordance with the requirements of this section.

E. <u>Description of Business; the Institution's Interdependent Relationship with its Funding Bank [§ 620.5(a)(10)]</u>

Section 620.5(a)(10) requires each association to disclose in its annual report the association's financial and supervisory relationship with its funding bank. In order that the section not be interpreted to require only disclosure of the financial and supervisory relationships, but also include all interdependent relationships between banks and associations, we propose to amend this section to remove language, such as "financial" or "supervisory," that may be interpreted to limit the disclosure of the interdependent relationship. While there is a financial and supervisory relationship between associations and funding banks that must be disclosed, we conclude that the disclosure should further include a discussion of all interdependent relationships so shareholders can understand the full extent of the relationship between an association and its funding bank.

F. <u>Description of Liabilities; Description of Statutory Responsibility for Repayment of Obligations Issued by the Farm Credit System Financial Assistance Corporation [§ 620.5(e)(4)]</u>

Section 620.5(e)(4) requires disclosure of System institutions' responsibility for repayment of obligations issued by the Farm Credit System Financial Assistance Corporation (FAC). Because the FAC has fulfilled its obligations and discharged its responsibilities under the Act and is no longer a chartered entity, we propose to remove § 620.5(e)(4) in its entirety.

G. <u>Selected Financial Data; Associations that are not Direct Lender Associations [§ 620.5(f)(2)]</u>

Section 620.5(f)(2) requires disclosure of selected financial data for each of the last 5 fiscal years in the annual reports of associations that are <u>not</u> direct lender associations. Due to System structure changes that occurred subsequent to the implementation of this section, all System associations are now direct lenders. Therefore, we propose to remove this section of the regulation in its entirety.

H. <u>Description of Funding Sources [§ 620.5(g)(3)(i)(A)]</u>

Section 620.5(g)(3)(i)(A) requires that an institution describe its outstanding consolidated Systemwide debt obligations and other bond obligations used to fund its lending operations. We propose to clarify that the requirement applies to all debt obligations held by each System institution, not just the consolidated Systemwide debt and bond obligations. For example, this section would require that an association describe the general financing agreement with its affiliated bank.

I. <u>Listing of Directors and Senior Officers and their Terms of Office [§ 620.5(h)(1)]</u>

Section 620.5(h)(1) requires the disclosure of the names of all directors and senior officers of the institution, their respective position titles and terms of office. Most senior officers, as employees, do not have agreed-upon terms of office with the institution. Therefore, in lieu of disclosing a term of office for a senior officer, we propose to amend this section to require disclosure of the date the senior officer commenced employment in his/her current position. The requirement to disclose the term of office for directors would remain unchanged.

J. Director Compensation [§ 620.5(i)(1)]

Section 620.5(i)(1) requires System institutions to make disclosures concerning the compensation of directors, including the total cash and noncash compensation paid to all directors as a group during the fiscal year. However, the current regulation does not specify whether the disclosures should include only those directors that are serving as of the date of the annual report, or if it should also include directors that received compensation during the fiscal year, whether or not serving as of the date of the annual report. As a result, disclosure practices vary among System institutions. Additionally, disclosure requirements for System institutions' CEOs at § 620.5(i)(2)(i)(A) specifically require disclosure of compensation paid to each individual CEO that served in his/her capacity as CEO during the fiscal year. In order to clarify the requirements for director compensation and to conform these requirements with the disclosures required for the CEO at § 620.5(i)(2)(i)(A), we propose to amend this section to clarify that the disclosures required by § 620.5(i)(1) apply to all directors that served in that capacity during the fiscal year, including those that resigned from the board or whose terms expired during the fiscal year.

K. Fees Paid to the Qualified Public Accountant Engaged to Conduct the Financial Statement Audit [§ 620.5(l)(2)]

Section 620.5(l)(2) requires each institution to disclose in its annual report all fees paid to its qualified public accountant, with the fees segregated into three categories: audit services, non-audit services, and tax services. The types of non-audit services must be individually identified and disclosed, and each institution must state whether the non-audit services were approved by its audit committee. This requirement applies only to the fees paid to the qualified public accountant engaged to conduct the institution's financial statement audit. The requirement is intended to help shareholders assess the independence of the institution's external auditor. It does not apply to fees paid to other qualified public accountants not engaged to conduct the institution's audit. Thus, we propose to amend § 620.5(l)(2) to make this clarification.

L. Preparing and Publishing the Quarterly Report [§ 620.10(a)]

On December 4, 2007, the FCA issued a final rule (72 FR 68060) amending the disclosure and reporting regulations for System institutions. The final rule revised the requirements for submitting part 620 reports to the FCA. Among other things, amended § 620.4 requires that each System institution prepare and send to FCA an electronic copy of its annual report and publish a copy of its annual report on its Web site when it sends FCA the electronic copy. This amendment intended to strike a balance between providing accelerated reporting and improved information flow to shareholders and investors, allowing sufficient time for the issuance of a paper copy of the annual report to shareholders. This amendment, however, did not address publication and filing requirements for quarterly reports to shareholders. To further facilitate timely disclosure of financial information and improved information flow to shareholders and investors, we propose to amend § 620.10(a) to include requirements for filing the quarterly report electronically with the FCA and publishing the report on the institution's Web site when it sends the report electronically to the FCA. The section does not require that the quarterly report be sent to shareholders. However, it must be made available for public inspection at the issuing institution.

Additionally, we propose to amend § 620.10(a) to replace the language "Farm Credit bank and direct lender association" with "institution," which is defined for purposes of § 620.1(f) to mean "any bank or association chartered by the Act."

M. Interim Financial Statements and Pro Forma Presentations Subsequent to Consummation of a

Business Combination [§ 620.11(b)(4) and (b)(5)], and Reporting Accounting Changes and Error Corrections [§ 620.11(b)(6) and (b)(7)]

The Financial Accounting Standards Board (FASB) develops and establishes financial accounting and reporting standards and the hierarchy under which those standards are to be applied (i.e., GAAP). The recent issuance by the FASB of certain standards has necessitated a review of our regulations that are affected by the new standards.

Section 620.11(b)(4) and (b)(5) established the interim financial reporting requirements for System institutions that consummated a business combination, merger, consolidation, etc. (hereinafter referred to solely as a business combination), using either the pooling or purchase methods of accounting. The interim financial reporting requirements were affected by the FASB's issuance in 2007 of Statement of Financial Accounting Standards (SFAS) 141(R) because:

- FCA regulations require that System institutions prepare financial statements and reports in accordance with GAAP, thus all System institutions are required to adopt SFAS 141(R) and its disclosure requirements;
- SFAS 141(R) requires that the acquisition method of accounting be used to account for all business combinations, including combinations of mutual enterprises, thus the references in § 620.11(b)(4) and (b)(5) to pooling and purchase methods of accounting are no longer relevant; and
- In deliberating the new standard, the FASB agreed that the definition of a mutual enterprise includes cooperative entities, thus the acquisition method of accounting prescribed by SFAS 141(R) is GAAP for System institutions.

SFAS 141(R) is effective for all business combinations that have an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Therefore, as of the effective date, System institutions will be required to apply SFAS 141(R) to business combinations with an acquisition date of January 1, 2009, or thereafter. Accordingly, since § 620.11(b)(4) and (b)(5) will no longer apply to current GAAP, we propose to remove these sections in their entirety.

FCA reporting requirements for accounting changes are found in § 620.11(b)(6) and (b)(7). The FASB issued SFAS 154, Accounting Changes and Error Corrections, which replaced Accounting Principles Bulletin Opinion No. 20 and SFAS 3 and changed the requirements for the accounting for and reporting of a change in accounting principles. SFAS 154 was effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Since SFAS 154 addresses the accounting and reporting requirements covered by existing § 620.11(b)(6) and (b)(7), and since System institution financial statements and reports are required to be prepared in accordance with GAAP, we propose to remove § 620.11(b)(6) and (b)(7) in their entirety.

N. Independent Public Accountant [§ 620.11(e) and § 620.21(f)]

Section 619.9270 provides FCA's definition of "qualified public accountant or external auditor." In order to ensure that § 620.11(e) and § 620.21(f) are consistent with the definitions established in § 619.9270, we propose to amend § 620.11(e) to replace the references to "independent public accountant" with "qualified public accountant or external auditor." Additionally, we propose to amend § 620.21(f) to replace each reference to "independent public accountant" or "accountant" with "qualified public accountant or external auditor."

O. Accounting for the Allowance for Loan Losses and Chargeoffs [§ 621.5(a)]

Our existing rule at § 621.5(a) on the allowance for loan losses states that System institutions shall maintain, at all times, an allowance for loan losses that is adequate to absorb all probable and estimable losses that may reasonably be expected to exist in the loan portfolio. This requirement was intended to be consistent with GAAP existing at the time. The accounting for the allowance for loan losses continues to evolve as additional pronouncements and other guidance are issued by the FASB and other standard-setting bodies. Therefore, to ensure that the accounting for the allowance for loan losses remains current with industry standards, we propose to amend this section by revising the language to clarify that a System institution's allowance for loan losses should be determined in accordance with GAAP.

P. Reports of Condition and Performance; Applicability and General Instructions; Filing of Reports [§ 621.12(c)]

We propose to revise this provision because all Call Reports are currently submitted electronically, and the instructions for the preparation of the Call Reports are available on the Agency's Web site. Additionally, we propose to amend § 621.12 to require that institutions file their Call Reports in accordance with the instructions prescribed by the FCA.

Q. Technical Corrections [§ 620.5]

In a previous rulemaking, § 620.5 was amended by removing the word "financial" and adding in its place the word "financing." The intent of the change, however, was to remove the word "financial" and add in its place the word "financing" only as it appeared in § 620.5(a)(8), rather than in §§ 620.5(a)(4), 620.5(e)(2), 620.5(f), 620.5(f)(1)(iii), 620.5(g), 620.5(g)(1)(iv), 620.5(g)(2)(ii), 620.5(g)(2)(vi), 620.5(j)(3)(ii), and 620.5(m)(1). Therefore, we propose to amend § 620.5 to correct instances where the word "financial" was inadvertently replaced with the word "financing."

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

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[1] Pub. L. 99-205, 99 Stat. 1678, Dec. 23, 1985.

[2] Pub. L. 92-181, 85 Stat. 583, Dec. 10, 1971.

[3] Pub. L. 107-204, 116 Stat. 745, July 30, 2002.

[4] A public company is a company that is permitted to offer its registered securities (stock, bonds, etc.) for sale to the general public, typically through a stock exchange, but also may include companies whose

stock is traded over the counter (OTC).

[5]Section 620.1(o) defines "report" as the "annual report, quarterly report, notice, or information statement, regardless of form, required by this part unless otherwise specified."

List of Subjects in 12 CFR Parts 619, 620 and 621

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

For reasons stated in the preamble, parts 619, 620, and 621 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 619--DEFINITIONS

1. The authority citation for part 619 continues to read as follows:

Authority: Secs. 1.4, 1.7, 2.1, 2.4, 2.11, 3.2, 3.21, 4.9, 5.9, 5.12, 5.17, 5.18, 6.22, 7.0, 7.1, 7.6, 7.8, 7.12 of the Farm Credit Act (12 U.S.C. 2011, 2015, 2072, 2075, 2092, 2123, 2142, 2160, 2243, 2244, 2252, 2253, 2254, 2278b-2, 2279a, 2279a-1, 2279b, 2279b-2, 2279f).

2. Section 619.9270 is amended by revising the second sentence of paragraph (e) to read as follows:

§ 619.9270 Qualified Public Accountant or External Auditor.

*** * * * ***

(e) * * * For the purposes of this definition, the term "independent" has the same meaning as under the rules and interpretations of the authoritative body governing overall audit performance. *** * ***

PART 620--DISCLOSURE TO SHAREHOLDERS

3. The authority citation for part 620 continues to read as follows:

Authority: Secs. 4.19, 5.9, 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2207, 2243, 2252, 2254, 2279aa-11); sec. 424 of Pub. L. 100-233, 100 Stat. 1568, 1656.

Subpart A--General

4. Section 620.3 is amended by revising paragraph (b)(3) as follows:

§ 620.3 Accuracy of reports and assessment of internal control over financial reporting.

*** * * * ***

(b) * * *

(3) A board member formally designated by action of the board to certify reports on behalf of individual board members.

*** * * * ***

Subpart B--Annual Report to Shareholders

5. Amend § 620.5 as follows:

a. Remove the word "financing" and add in its place the word "financial" each place it appears in paragraphs (e)(2), (f) introductory text, (f)(1)(iii), (g) introductory text, (g)(1)(iv), (g)(2)(ii), (g)(2)(vi), (j)(3)(ii), and (m)(1);

b. Revise the introductory paragraph, paragraphs (a)(4), (a)(10) introductory text, (g)(3)(i)(A), (h)(1), (i), and the first sentence of paragraph (l)(2);

c. Remove paragraphs (a)(10)(v), (e)(4) and (f)(2); and

d. Redesignate existing paragraphs (f)(3) and (f)(4) as newly designated paragraphs (f)(2) and (f)(3).

§ 620.5 Contents of the annual report to shareholders.

The report must contain the following items in substantially the same order, except that information required by paragraphs (a) through (e) of this section may be referenced to information required by paragraph (g) so long as the descriptions and disclosures are appropriately included in paragraph (g) of this section:

(a) * * *

(4) Any significant developments within the last 5 years that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends, including, but not limited to, changes in the reporting entity, changes in patronage policies and practices, and financial assistance provided by or to the institution through loss-sharing or capital preservation agreements or from any other source;

* * * * *

(10) For associations, in a separate section of the annual report, discuss the interdependent relationship between the association and its funding bank, including, but not limited to, the financial relationship, a service provider relationship, other material operational relationships, and other specific issues or areas that create a material interdependent relationship between the association and its funding bank. This separate section may reference information from other sections of the annual report. At a minimum, the separate section must include the statement required by § 620.2(h)(2)(i) of this part and the following information required elsewhere in this section, if applicable:

* * * * *

(g) * * *

(3) * * *

(i) * * *

(A) Describe the average and yearend amounts, maturities, and interest rates on outstanding consolidated Systemwide debt obligations, bond obligations, or any other obligations used to fund the institution's lending operations.

* * * * *

(h) * * *

(1) List the names of all directors and senior officers of the institution, indicating the position title and term of office of each director, and the position, title, and date each senior officer commenced employment in his or her current position.

* * * * *

(i) *Compensation of directors and senior officers*.

For the purposes of this paragraph, disclosure of compensation paid to and days served by directors applies to any director who served in that capacity at any time during the reporting period.

* * * * *

(l) * * *

(2) Disclose the total fees, by the category of services provided, paid during the reporting period to the qualified public accountant engaged to conduct the institution's financial statement audit. * * *

* * * * *

Subpart C--Quarterly Report

6. Amend § 620.10 by revising paragraph (a) to read as follows:

§ 620.10 <u>Preparing the quarterly report</u>.

(a) Each institution of the Farm Credit System must

(1) Prepare and send, to the Farm Credit Administration, an electronic copy of its quarterly report within 40 calendar days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution; and

(2) Publish a copy of its quarterly report on its Web site when it sends the report electronically to the Farm Credit Administration.

*** * * * ***

§ 620.11 [Amended]

7. Amend § 620.11 as follows:

a. Remove paragraphs (b)(4) through (b)(7);

b. Redesignate existing paragraph (b)(8) as newly designated paragraph (b)(4); and

c. Remove the words "independent public accountant," "an independent public accountant," and "the independent public accountant" and add the words "a qualified public accountant or external auditor" in each place they appear in paragraph (e) and its heading.

<u>Subpart E--Annual Meeting Information Statement</u>

8. Amend § 620.21 by revising the heading and paragraph (f) to read as follows:

§ 620.21 <u>Contents of the information statement and other information to be furnished in connection with the annual meeting or director elections</u>.

*** * * * ***

(f) *<u>Relationship with qualified public accountant or external auditor</u>*. If an institution of the Farm Credit System has had a change or changes in its qualified public accountant or external auditor since the last annual report to shareholders, or if a disagreement with a qualified public accountant or external auditor has occurred, the institution shall disclose the information required by § 621.4(c) and (d) of this chapter.

PART 621--ACCOUNTING AND REPORTING REQUIREMENTS

9. The authority citation for part 621 continues to read as follows:

<u>Authority</u>: Secs. 5.17, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2279aa-11); sec. 514 of Pub. L. 102-552.

<u>Subpart A--Purpose and Definitions</u>

10. Amend § 621.2 by revising paragraph (d) to read as follows:

§ 621.2 <u>Definitions</u>.

*** * * * ***

(d) *Generally accepted auditing standards* means the standards and guidelines that are generally accepted in the United States of America and that are adopted by the authoritative body that governs the overall quality of audit performance.
*** * * * ***

Subpart B--General Rules

11. Amend § 621.5 by revising paragraph (a) to read as follows:

§ 621.5 Accounting for the allowance for loan losses and chargeoffs.
*** * * * ***
(a) Maintain at all times an allowance for loan losses that is determined according to generally accepted accounting principles.
*** * * * ***

Subpart D--Report of Condition and Performance

12. Amend § 621.12 by revising paragraph (c) as follows:

§ 621.12 Applicability and general instructions.
*** * * * ***
(c) All reports of condition and performance shall be submitted electronically in accordance with the instructions prescribed by the Farm Credit Administration and located on its Web site.

Dated: November 17, 2008.

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

74 FR 17612, 04/16/2009

Handbook Mailing HM-09-1

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 613, 615, 619 and 620

RIN 3052-AC43

Organization; Eligibility and Scope of Financing; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Definitions; and Disclosure to Shareholders; Director Elections

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is proposing to amend our rules on Farm Credit System (System) bank and association director elections and other voting procedures to clarify director election processes and update our rules to incorporate interpretations made through several recent bookletters to System institutions. We propose consolidating general election procedures, clarifying the role of nominating committees, enhancing eligibility and disclosure requirements for director-candidates, and improving annual meeting information statement instructions. We also propose new regulations on floor nominations and meetings of stockholders. We expect this proposed rule will increase stockholder participation in the director election process and enhance impartiality and disclosure in director elections.

DATES: You may send comments on or before June 15, 2009.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090

You may review copies of all comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Elna Luopa, Senior Corporate Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Laura D. McFarland, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. <u>Objectives</u>

The objectives of this proposed rule are to:

- Strengthen the independence of nominating committees;
- Encourage greater stockholder participation in the director election process;
- Ensure procedures on nominations from the floor are equitable and known to stockholders;
- Clarify director election procedures;
- Enhance impartiality and disclosure in the election of directors; and
- Incorporate FCA interpretations and responses to questions raised by System institutions and FCA examiners in our rules.

II. <u>Background</u>

The Farm Credit Act of 1971, as amended (Act),[1] establishes the System as a farmer-owned cooperative system that provides credit to farmers, ranchers, producers or harvesters of aquatic products, and rural home owners. The cooperative structure of the System relies on the owner control and participation of its stockholders and is supported by the accurate and timely information provided by the directors of System institutions. The majority of all Farm Credit bank and association directors are elected by voting stockholders.[2]

One of the main objectives of cooperatives today, as in the past, is to promote the participation of members in the management, ownership, and control of the cooperative, which includes electing directors to represent the interests and concerns of all the institution's owner-borrowers. Boards of directors in a cooperative system have the responsibility of encouraging stockholder participation in the management and control of the cooperative. The capacity of the board of directors to view borrowers as owners as well as customers is key to a successful cooperative enterprise. Respecting borrowers as owners is indispensable to creating stockholder interest and activity in the institution's existence as a cooperative. Providing stockholders the opportunity to give voice to their concerns through various forums, such as an annual stockholders' meeting, gives the board of directors the feedback they need to measure how well they are serving all their stockholders' interests. It is from this pool of interested, active, and informed stockholders that the cooperative draws its next generation of directors.

For these reasons, we are strengthening certain provisions on election of directors and adding other provisions to ensure that stockholders' voices continue to resound in the boardroom through their elected representatives. We are further proposing to consolidate our general director election rules, currently located throughout our rules, into subpart C of part 611, "Election of Directors and Other Voting Procedures." Our rules at part 611 were intended to address election procedures, and we believe consolidating our election rules into this section is appropriate. We believe the proposed reorganization will add clarity to our rules by keeping subject matters together, thereby facilitating System compliance. In the proposed process of consolidating provisions, some regulatory language is proposed to be changed to remove redundancy and enhance clarity.

III. Comments Received

We received two comments on our existing election regulations prior to developing these proposed rules. The comments were in response to a June 23, 2008, regulatory burden solicitation (73 FR 35361). We evaluated the comments in recognition of existing law and policy considerations and the cooperative nature of the System.

One commenter asked us to consider overall revisions to our election rules, but made no suggestions on what changes should be made. The second commenter requested we modify our rules at § 611.325 and § 615.5230 to allow stockholders to nominate and elect directors in any manner they consider appropriate, as long as the process is fair and equitable. Our existing rules do not prevent voting stockholders from using various means to nominate directors as long as the right to make floor nominations and use a nominating committee remains available. The Act, at section 4.15, requires associations to use nominating committees and permit floor nominations in director elections. Institutions wishing to use additional methods, such as nominations by petition, may do so. Further, our rules do not prevent stockholders from using multiple methods, such as mail ballots and regional elections, in electing directors. We propose expanding the options in this proposed rule by introducing online meetings. Our rules, however, provide protections for the cooperative structure of the System by limiting each association stockholder to one vote and providing weighted voting for Farm Credit Banks. This proposed rule carries forward that concept in our impartiality in elections rules at § 611.310, while also increasing the flexibility of institutions by proposing to treat the associations who are stockholders in a Farm Credit bank in the same manner that a stockholder is treated at the association level when campaigning for director-candidates. We believe we have balanced the rights of stockholders with legitimate safety and soundness concerns in our regulations and continue that balance in this proposed rule.

IV. Section-by-Section Analysis

A. Meetings of Stockholders [new §§ 611.100, 611.110, and 611.120]

We propose adding a new subpart A to part 611 that would address meetings of stockholders and consist of three sections. The three sections we are proposing are § 611.100 for definitions, § 611.110 to address the basic aspects of meetings of stockholders, and § 611.120 on establishing a quorum for stockholders' meetings.

1. Stockholders' Meetings [new § 611.110]

The proposed § 611.110 would capture the existing practices of System institutions in holding annual director elections. It would also incorporate and cross-reference the notice of meeting requirements currently found in § 620.21 and allow for the use of online meetings as part of the annual meeting process. In today's rapidly changing environment, System institutions are able to employ new technologies to support online meetings conducted over the Internet, creating more opportunities for facilitating member attendance and involvement. These opportunities help mitigate attendance issues arising from larger territories and the costs and inconveniences associated with traveling long distances. In proposed § 611.110, System institutions would be permitted to use online meetings to augment their traditional annual meeting held in a physical location within the institution's territory. Each bank and association using an online meeting space would need to develop policies and procedures that would provide stockholders with the information needed to access the online meeting and register their attendance. Because not all stockholders may have the means to use online technology, online meetings would not substitute for an actual physical meeting location for the annual meeting, but would be in addition to it.

2. Stockholder Attendance [new § 611.110(d)]

We are proposing a requirement that Farm Credit banks and associations actively encourage stockholder attendance at the annual meeting. We encourage institutions to consider using the Annual Meeting Information Statement (AMIS) or other shareholder communications to describe the various opportunities for shareholders' participation in the ownership, control, and management of their institutions. For instance, opportunities may include shareholder appreciation meetings, financial results conference calls, sponsorship of conferences, educational and other agricultural credit-related events, participation in advisory committees, and the opportunity to serve on the institution's board of directors or nominating committee. FCA believes strongly that the Act places significant expectations on System institutions to foster and facilitate shareholder involvement and knowledge of the cooperative nature of the System. As a result, FCA encourages System institutions to be creative in finding ways to reach out to member-shareholders beyond the lending relationship, providing for related services, or simply distributing copies of required disclosures.

3. Quorums [new § 611.120]

The proposed § 611.120 would clarify requirements for Farm Credit institutions' determining if a quorum at a stockholders' meeting was achieved and require institutions to identify quorum requirements in their bylaws. A quorum is the minimum number of voting stockholders necessary to conduct business, including holding a vote. As such, we propose that a quorum count may not include mail ballots. General corporate law principles define a quorum as "the number of persons who must be present before any business can be transacted at a meeting.[3] Since mail balloting occurs after a meeting is convened and is an actual component of the business of a meeting, mail ballots cannot be used to establish that there were a sufficient number of voting stockholders present at the start of the meeting. Because our proposed rule in § 611.110 would permit Farm Credit institutions to hold online annual meetings, at which voting stockholders can register their attendance electronically, we believe versatility and sufficient flexibility exist to enable the institution to meet its quorum requirement without the necessity of including mail ballots for that purpose. We are proposing a delayed date for the prohibition on using mail ballots to establish a quorum because we are aware that some Farm Credit institutions may currently allow the counting of mail ballots to determine whether a quorum has been met and will have to amend their procedures accordingly.

The proposed rule would not affect counting proxy ballots towards the quorum requirement because proxies are treated as "present" and voting members.[4] In order to execute a proxy, the person designated as the proxy holder must be in attendance at the stockholders' meeting. Our proposed rule would also continue to allow those Farm Credit institutions holding annual meetings of stockholders, or any special meeting of stockholders, in consecutive sectional sessions to count the attendance of voting stockholders at all sessions for quorum purposes, provided no voting stockholder is counted more than once. Further, if a quorum is present when a meeting is first convened, the meeting may be recessed to a later time and, when reconvened, be held as a legal meeting even if a quorum is no longer present.

We encourage institution boards to renew their efforts to meet their existing quorum requirements as a result of this proposed change. The board of directors of the cooperative has an important role to play in maintaining open and direct communications with the cooperative's owners. An annual meeting of stockholders provides a unique opportunity for the cooperative's members and their majority-elected directors to reflect on the accomplishments and challenges of the past year and discuss their goals for the future. The annual meeting is also a forum for member-owners to meet with their directors and other members to discuss member concerns and member satisfaction. Taking actions that result in a well-attended stockholders' meeting reflects the board's collective commitment in meeting the needs of its members. Consequently, institutions should consider ways for encouraging stockholder-owner involvement and attendance at annual meetings, even though mail ballots may not be used for quorum purposes. The opportunity to hold annual meetings online and include, in the quorum count, the voting stockholders attending the online meeting is likely to satisfy an institution's existing quorum requirement.

B. <u>Eligibility for Membership on Board of Directors</u> [§ 611.310]

We propose modifying the language of existing § 611.310(b)--regarding director eligibility when there is a case of incompetence or criminal conviction--to mirror the statutory language at section 5.65(d) of the Act. Our existing regulatory language identifies felony convictions, but the Act makes no distinction between misdemeanor and felony convictions. Our proposed change would bring the regulatory text into compliance with the Act.

We propose adding new paragraph (e) addressing director eligibility when a person has run for membership on a nominating committee. Our existing rule at § 611.325 already prohibits this dual role, but we believe further clarity is required. We propose clarifying that a person is not eligible to be a director if that person is elected to serve on the institution's nominating committee and attends a meeting of the nominating committee. Attending a meeting of the nominating committee could give a committee member the ability to access information that would allow that person to judge the likelihood of a successful run for the board, thus creating a potential conflict of interest that the rules in § 611.310 seek to avoid. For this reason, we propose including the existing § 611.325 prohibition in § 611.310 after making clarifying changes to § 611.325 to allow a nominating committee member to step down and run as a director-candidate in an election as long as the member has not attended a nominating committee meeting.

We are also proposing to add a new paragraph (f) in § 611.310 that would allow out-of-territory borrowers to serve as association directors. Many out-of-territory borrowers, who are eligible borrowers under § 613.3000, are voting stockholders in their institutions and, as such, are potentially eligible to run for election to the institution's board of directors. We propose giving the institution the discretion to limit out-of-territory borrowers' opportunity to run for the board if made a part of the institution's bylaws. Associations would also be required to inform, in writing, an out-of-territory borrower at the time the loan is made as to the borrower's eligibility to serve as a director.

C. <u>Impartiality in the Election of Directors</u> [§ 611.320]

1. <u>Institution Resources</u> [§ 611.320(c)]

Our existing rule at § 611.320(c) on impartiality in elections states that no resources of an institution may be used by a candidate for nomination or election unless the same resources are simultaneously made available, and made known, to all declared candidates. We propose clarifying this provision to explain that facilities and resources include an institution's information technology resources and financial resources. For example, an institution may use its financial resources to provide reasonable reimbursement of travel expenses of director-candidates to attend annual meetings (including sectional sessions) if all candidates are offered the same reimbursement. We propose this clarification to ensure that institutions that have paid the travel expenses of incumbent directors running for re-election do not deny other candidates reimbursement for similar travel expenses. We also propose clarifying that when resources are made available to all candidates, the institution must also make the resources available to floor nominees. To ensure that all candidates, including any floor nominees, are aware of an institution's policy that permits candidate reimbursement, we would expect the institution to include stockholder notice, in the AMIS or elsewhere, that candidates will be provided the opportunity to receive reasonable travel reimbursement. The advance notice to voting stockholders would help ensure fairness and equal access to the reimbursement opportunity. In no instance may an institution provide its financial resources in a manner that results in personal financial gain for the candidate(s). Use of an institution's financial resources must be reasonable, prudent, and consistent with supporting an election that is fair and unbiased.

We further propose amending paragraph (c) to recognize associations as stockholders in their funding banks. We propose treating associations as stockholders and not as "institutions" to allow stockholder-associations to use their property, facilities, and resources in support of a candidate to the bank board. As part of this proposal, stockholder-associations would be able to exercise their rights as stockholders in supporting a bank director-candidate -- if authorized by the affiliated Farm Credit bank's impartiality in director elections' policies and procedures. Our rule would require the bank's policy and procedures to set reasonable standards for stockholder-associations' use of their property, facilities and resources for this purpose. For example, we would expect the bank to establish a reasonable amount that stockholder-associations could expend in supporting a bank director-candidate. In establishing the reasonable amount, the bank would need to take into consideration the various sizes of the associations in its district before establishing the maximum amount that could be expended by a stockholder-association. The bank's policy and procedures must be fair and equitable and be clear that the amount expended by a stockholder-association is not for the personal use of any bank director-candidate. The bank's policy could also identify that using photocopying facilities, mailing materials, and the like are acceptable uses of the stockholder-association's resources, but cash outlays are not an acceptable use. Likewise, banks may want to permit stockholder-associations to host moderate social gatherings or reimburse travel expenses in order to introduce candidate(s) to the bank's other voting stockholders.

We believe requiring the bank to authorize the use of association property, facilities, and resources is appropriate because it is the bank's director election process and the bank should have the authority to determine the allowable activities of its stockholders in this process, subject to our regulations. In the event a bank does not choose to allow its stockholder-associations to use property, facilities, and resources in support of bank director-candidates, no stockholder-association in that district would be authorized to provide campaign support to any bank director-candidate in any manner.

We caution System institutions that stockholder-associations may not write checks to any bank director-candidate to support his or her campaign. It is critical that any support provided by a stockholder-association to a bank director-candidate not result in enriching the candidate or providing the candidate with personal financial gain. Should the candidate win election to the board, we believe that such actions may create a conflict of interest in the director's execution of his or her fiduciary duties on behalf of all stockholders

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As a technical change, we propose replacing the phrase "System institution" with "Farm Credit" everywhere it appears in § 611.320.

2. Involvement of Directors in Board Elections [new § 611.320(f)]

We propose adding a new paragraph (f) to address the involvement of directors in board elections. While our existing rule at § 611.320(b) prohibits, in part, employees and agents from making statements intended to influence votes in elections and nominations, we propose adding a prohibition for directors of Farm Credit institutions from actively supporting a candidate for nomination or election to that institution's board of directors. We believe a director's active support of a candidate creates a potential for conflicts of interest should that director-candidate be elected to the board. An example of prohibited conduct would include a sitting director of an institution distributing or mailing a letter to the voting stockholders endorsing a particular candidate for director (other than him or herself). We are proposing to limit this restriction to activities made on another's behalf. Therefore, the proposed rule would allow any director to freely engage in campaign activities for his or her own election to the board.

D. Nominating Committees [existing § 611.325]

We are proposing that each institution establish and maintain policies and procedures on the formation, operation and duties of its nominating committee, consistent with current laws and regulations. While the nominating committee is a committee of voting stockholders and not a committee of the board, the institution's use of policies and procedures will help meet its obligation to ensure the independence and integrity of the nominating committee process in the election of directors for each and every election cycle. To that end, policies and procedures for the institution's nominating committee would help ensure that nominating committee members are fully informed of their rights and obligations as they perform this important service to their cooperative.

We further propose clarifying that each institution may have only one nominating committee in any one election cycle, consistent with informal guidance we have provided in our brochure on nominating committees, our March 8, 2007 bookletter, "Guidance on Farm Credit Bank and Association Nominating Committees" (BL-043 Revised), and Frequently Asked Questions (FAQ) on our Web site.

1. Nominating Committee Composition [existing § 611.325(a)]

We are proposing to add a requirement to paragraph (a) that would permit out-of-territory borrowers, who are voting stockholders, to serve on an institution's nominating committee. The proposed rule would recognize that an institution may prohibit eligibility for such activities by out-of-territory borrowers in its bylaws. Associations would also be required to inform, in writing, the out-of-territory borrower, at the time the loan is made, whether the borrower is eligible to serve on the nominating committee. We also propose moving the existing § 611.325(a) prohibitions on membership to the nominating committee to proposed new paragraph (c), which is discussed further below.

2. Nominating Committee Election [new § 611.325(b) and existing § 620.21]

We propose amending our existing rule at § 611.325 by adding a new paragraph (b) on nominating committee elections. We propose clarifying that an institution may use ballots that would allow stockholders to vote for nominating committee members as a slate, as long as stockholders also retain the ability and right to elect members individually. We have encountered questions on whether institutions may present voting stockholders with a list of candidates, identifying only one name for each vacant committee position, and then requiring stockholders to vote either for or against the entire list. Allowing institutions to determine the entire composition of the committee in this manner does not give voting stockholders an ability to choose the individual members of the nominating committee. The proposed rule would not prevent an institution from offering its voting stockholders the option of voting on the list of candidates as an alternative to voting on each individual candidate running for the nominating committee, but the institution would not be allowed to require voting stockholders to vote only for or against the list of nominating committee candidates. We believe that the institution is responsible for developing an open and impartial process for soliciting candidates for nominating committee membership. The process must ensure that the institution, its directors and management, and the existing nominating committee are not naming successors for, or appointing members to, the nominating committee. In our BL-043 Revised, we suggest ways in which potential nominating committee candidates can be identified.

We also propose clarifying in § 611.325(b) that association nominating committee members may only be elected to serve a 1-year term. Section 4.15 of the Act requires each association to elect a nominating committee at the annual meeting to serve for the following year. Individual members of an association nominating committee may be elected to sequential 1-year terms, however. We are not proposing term limits for bank nominating committee members because we recognize that some banks do not conduct their director elections at annual meetings, and there is no statutory provision limiting the terms of bank nominating committees. We further propose clarifying that each Farm Credit Bank, but not agricultural credit banks or banks for cooperatives, must use weighted voting procedures when electing members to their nominating committees. We propose this change to conform the nominating committee election procedure to our existing rules on Farm Credit Banks' director elections. These proposed changes are consistent with informal guidance we have provided in our brochure on nominating committees, BL-043 Revised, and Frequently Asked Questions (FAQ) on our Web site.

2. Nominating Committee Conflicts of Interest [new § 611.325(c)]

We are proposing regulatory language on conflicts of interest for nominating committees in a new paragraph (c) to § 611.325. We propose moving the existing § 611.325(a) prohibitions on membership to the nominating committee to this new paragraph and adding proposed language clarifying that once elected to a nominating committee, a member may not resign from the committee to be considered as a candidate for a director position if the member has attended a meeting of the nominating committee. We previously explained this limitation in the preamble to the original rulemaking for § 611.325.[5] This clarification is important because we have received numerous questions regarding whether nominating committee members may resign from the committee or recuse themselves from committee deliberations in order to be a director-candidate. Our existing rule at § 611.325(a) prohibits an individual from running for election to the board of directors if that same individual already successfully ran for election to the nominating committee that is identifying director-candidates in that election cycle. We believe that to preserve impartiality, committee members must be free from any interest in a directorship during service on the nominating committee. We continue to believe that an open and fair nominating process must be free of potential conflicts that could result if a nominating committee member, once elected, attends a meeting of the nominating committee and is allowed to recuse himself or herself from committee discussions or resign from the committee in order to run for director in that same election cycle. While we believe that a stockholder has adequate time to decide whether a directorship or nominating committee membership would allow him or her to best serve the cooperative for that election year cycle, we understand that situations may arise that beg reconsideration of the stockholder's original decision. In such situations, we are proposing that a person elected to the nominating committee, but who did not attend any meeting of the nominating committee, may resign his or her position. We are also proposing that nominating committees keep minutes of their meetings, which would reflect attendance. We further encourage institutions to elect alternate members to the nominating committee so the committee can function without interruption if a member decides to resign his or her position on the nominating committee. For example, if nominating committee members are elected by nomination region and the person resigning is the only representative from a region, the institution would have to hold elections to replace the member who resigned if no alternate had been elected to take his or her place.

3. <u>Nominating Committee Duties</u> [redesignated § 611.325(d)]

We propose redesignating paragraph (b) on nominating committee responsibilities as paragraph (d), clarifying that nominating committees may not be used for other institution business and adding a requirement that nominating committees keep records of their meetings. We believe having other duties diverts the nominating committee from its very significant role in the director election process, and therefore we propose limiting its duties to those described in proposed § 611.325(d). For example, some institutions are giving the nominating committee the task of identifying candidates for election to the nominating committee for the following year. While the institution may invite the nominating committee to suggest names of individuals who may have an interest in succeeding them on the committee, it goes beyond the nominating committee's role to determine the candidates who will stand for election to the next nominating committee. In other occurrences, the nominating committee has been tasked with verifying the eligibility or credentials of a floor nominee. The institution, not the nominating committee, is responsible for ensuring that the floor nominee is eligible. In addition, the nominating committee has completed its tasks for that election cycle before floor nominations are made or accepted.

We are not proposing to prohibit institutions from forming other stockholder committees for various purposes where some or all of the nominating committee members may serve on those committees. We are proposing to clarify that the nominating committee itself may not be used for functions other than those required by section 4.15 of the Act.

4. <u>Nominating Committee Resources</u> [redesignated § 611.325(e)]

We propose redesignating paragraph (c) on nominating committee resources as paragraph (e) and adding a provision that institutions provide their nominating committees with FCA rules and other FCA-issued guidance on the operation of nominating committees. We believe this requirement is necessary to ensure that the nominating committee is aware of FCA's rules and guidance regarding the nominating committee's role in representing the institution's stockholders in the director elections process and understands how it must operate in accordance with those rules.

E. <u>Floor Nominations</u> [new § 611.326]

We propose moving eligibility and procedural requirements for floor nominations from existing § 620.21(d) to new § 611.326. We also propose incorporating previous guidance provided to System institutions in our February 14, 2008 bookletter, "Floor Nomination Procedures for System Associations and Banks" (BL-055), and addressing floor nomination procedural requirements for various balloting methods.

Making nominations from the floor is an express right of each association's voting stockholder that may not be unduly restricted in a way that effectively weakens it.[6] As explained in BL-055, the procedures for nominations from the floor may not be unduly burdensome nor have the effect of denying voting stockholders the right to name candidates through floor nominations. We propose requiring System associations, and those Farm Credit banks that allow floor nominations, to have policies and procedures for accepting nominations from the floor. The proposed rule would set minimum procedural limits for the level of voting stockholder support that may be required by the institution before accepting a floor nomination. The proposed limit is no more than a second to a nomination. The proposed rule would also require that a floor nominee accept the nomination prior to placing the nominee on the ballot and clarify that floor nominations may be called for only after the nominating committee has identified its slate of director candidates.

We are also proposing to address a concern that allowing nominations from the floor only at the physical locations of the annual meeting may create delays and meeting inefficiencies because the institution first has to verify that the nominee is eligible for the position for which he or she has been nominated before the meeting can continue. Our proposed rule in § 611.110(c) would permit online annual meetings. Once the chairperson of the online annual meeting declares the meeting open, a "virtual floor" would allow a voting stockholder to make a "virtual floor nomination" through the interactive online meeting space. Virtual floor nominations would require using an "instant access" method such as "instant messaging" or a telephone call to the institution, both of which are unedited as in a physical meeting. An acceptable "instant access" method would be one that enables voting stockholders to second the floor nomination immediately and for the nominee to accept the nomination. For example, instant messaging to an online meeting space or a comment board would be considered sufficiently "instant," as well as being public to all voting stockholders. An e-mail or voice mail system would not be considered instant, as the institution staff would have to transfer the information to the virtual floor. This virtual floor could remain open for several hours or be recessed and reopened for several days at set times, enabling the institution to obtain floor nominee eligibility information before voting begins. We believe this process addresses the concerns for time to verify eligibility of candidates and the integrity of the floor nomination process. Floor nominations are public nominations of candidates that are not previously vetted by any person or committee. Ensuring the "public" nature and instant responses by stockholders to a floor nomination are essential. Because of the various forms of, and rapid changes in, technology, as well as recognizing the diversity of operations within the System, we are not proposing specific rules on how this innovative online meeting process occurs. We would expect Farm Credit institutions to develop procedures that address the core elements contained in this proposed rule.

If an institution uses a virtual floor in connection with an online meeting, this would not replace the floor at the physical location of the annual meeting. The institution must allow voting stockholders to nominate from the floor at any physical location of the annual meeting if voting stockholders will vote on director-candidates by paper or electronic mail ballot after all sessions of the annual meeting are concluded. Or, if the institution permits stockholders to vote in person at the meeting, then a voting stockholder must be allowed to nominate from the floor at the initial physical location of the annual meeting. It is for these reasons we also propose requiring banks and associations to inform stockholders in the AMIS of the procedures for making floor nominations.

F. <u>Director-Nominee Disclosures</u> [new § 611.330 and existing § 620.21]

We propose moving the existing requirements on director-nominee disclosures from § 620.21(d) to a new § 611.330 called "Disclosures of Farm Credit bank and association director-nominees." We believe that these requirements are process-related, describing steps that are taken in conducting director elections, and do not belong in part 620, which covers reporting requirements. We propose an additional provision in new paragraph (a) of § 611.330, which would require that each institution adopt policies and procedures addressing the acquisition of director-nominee disclosure statements to ensure that all director-nominees are fairly treated in the election and voting processes. We previously provided guidance on this matter in our September 11, 2008 bookletter, "Distribution of Director Candidate Information" (BL-056).

As a conforming technical change, we propose changing the reference in § 611.320(e) from § 620.21(d) to § 611.330.

G. <u>Regional Voting in Director Elections</u> [new § 611.335 and existing §§ 615.5230(a) and 620.21(d)]

We propose moving the existing requirements on regional director elections to a new § 611.335 called "Regional voting in director elections" to enhance the clarity and organization of our rules. We propose moving the regional voting procedures contained in existing § 615.5230(a)(3) and § 620.21(d)(4)(ii) to a new § 611.335 because existing § 620.21 is an interim report to stockholders (AMIS) and § 615.5230 addresses equity issuances in cooperative principles. As a conforming technical change, we propose deleting the paragraphs addressing regional elections contained in § 620.21(d)(4) and § 615.5230(a)(3).

H. <u>Confidentiality and Security in Voting</u> [§§ 611.330 and 611.340]

We propose consolidating into § 611.340 the "security in voting" rules and the "confidentiality in voting" rules currently located in existing §§ 611.330 and 611.340. We believe the consolidation will eliminate redundancy and make the rule easier to read. As part of the consolidation, we propose clarifying that only an independent third party or a tellers committee may validate and tabulate votes. The proposed clarification would remove a provision that allows another designated group of persons to perform these tasks. We do not believe an institution needs to designate any other group of individuals to validate and tabulate ballots when it can use a tellers committee or an independent third party for this purpose. We also propose new language on the membership of a tellers committee in paragraph (a)(4). We propose that only voting stockholders who do not have a conflict of interest may serve on the tellers committee. That is, only those voting stockholders who are not directors, director-candidates, or serving on the current election-year nominating committee may be members of the tellers committee. Institution employees who hold voting stock in the institution remain eligible to serve on a tellers committee. This limitation ensures that only those voting stockholders who have had no direct involvement in the nomination or election process are tabulating and counting ballots.

We further recognize the practical need for institutions to identify eligible voting stockholders as of the record date set for each stockholder voting action in paragraph (a)(2). The list of stockholders indicates the names of those stockholders holding voting stock as of the record date and thus the stockholder's eligibility to cast a ballot. Each institution is expected to update its list of stockholders, including individuals designated to vote for a legal entity that is a voting stockholder, each time the record date is set for director and nominating committee elections or any other matter requiring a stockholder vote. An updated list is also essential to determine if a floor nominee for a director position or membership on the nominating committee is a voting stockholder.

As a clarifying change, we propose adding language to paragraph (d) to explain that only proxy ballots may be accepted before stockholder meetings are convened for election or other voting purposes. Accepting mail ballots before an annual meeting results in those stockholders being unable to consider any candidate nominated from the floor because mail ballots cannot be revoked once received by the institution. Proxy ballots must be returned to the institution by the date of the stockholders' meeting and before balloting begins. The stockholder voting by proxy may withdraw the proxy authorization and vote in person at the meeting. Thus, a nominee from the floor could conceivably uphold a viable candidacy with sufficient stockholder support from those voting at the meeting as well as those that decide to revoke their proxy ballots and vote in person at the meeting.

As a conforming technical change, we propose changing the reference in § 611.1240(e) from §§

611.330 and 611.340 to § 611.340.

I. Cooperative Principles in Elections [§§ 611.350 and 615.5230(a)]

We propose moving the contents of existing § 615.5230(a)(1) and (a)(2), addressing voting rights of stockholders in Farm Credit bank and association director elections, to existing § 611.350 on cooperative principles in director elections. We propose no changes to the § 615.5230 provisions on how many votes a stockholder may cast, but propose minor rewording of the language for clarity and to recognize the proposed new location of these provisions.

We also propose adding a new provision to § 611.350 to clarify that out-of-territory borrowers holding voting stock must be assigned to a specific geographic region for voting purposes if the association apportions its territory into regions for voting purposes. Section 4.15 of the Act requires the nominating committee of each association to review a list of farmers from the association's territory and seek to nominate director-candidates representing all sections of the territory. Also, sections 2.1 and 2.11 require that elected directors come from the voting members (voting stockholders) of the association. We believe that these provisions, when read together, allow all voting members of an association, including out-of-territory borrowers, to have equal standing in the association in terms of voting stock. As discussed earlier in section IV.B. of this preamble (see discussion on § 611.310(f)), each institution must determine whether out-of-territory borrowers may serve the institution in other ways, such as on the board of directors or the nominating committee.

We also propose moving the provision requiring the disclosure of the types of agriculture in which directors of an institution engage from the existing provision at § 615.5230(b)(5) to § 620.21. We further propose, as a technical change, removing the remaining portions of § 615.5230(b)(5) regarding the nomination of at least two candidates for each director position as it is redundant of § 611.325.

J. Annual Meeting Information Statement (AMIS)

We propose renaming subpart E to clarify that an AMIS is used for more than an annual meeting. We also propose dividing the existing § 620.21 into two sections, one to address preparation and distribution of an AMIS and the other to address the contents of an AMIS. We propose this change to conform the AMIS to our other reporting sections.

1. Preparing and Distributing the AMIS [new § 620.20]

We propose moving that portion of the existing introductory language of § 620.21, discussing distribution of the AMIS to shareholders, to new § 620.20 and adding a requirement that the AMIS be dated. We believe that without a date of preparation, the value of the information in the AMIS is difficult to determine. We also propose an outside timeframe of 30 business days for distributing the AMIS to shareholders. The existing rule requires an AMIS be provided to shareholders at least 10 days before a meeting or election to ensure the shareholders' receipt before the meeting. We believe an outside timeframe is needed to ensure that the information in the AMIS is reasonably current at the time the shareholders' meeting or director elections take place. We also propose clarifying that the existing requirement to provide the AMIS no later than 10 days before a meeting means business days. We further propose referencing in paragraph (b) of new § 620.20 the existing signature and filing requirements of §§ 620.2 and 620.3 for all reports, specifically that the AMIS be provided to the Farm Credit Administration and that every AMIS be signed and dated. Institutions are required in § 620.3(b) to sign all reports, including the AMIS, and we are proposing to reference this requirement in § 620.20 to facilitate compliance with our rules. We are also proposing to include a requirement that the AMIS be electronically filed with the FCA at the time it is issued. On December 4, 2007, the FCA issued a final rule (72 FR 68060) amending the disclosure and reporting regulations for System institutions. As part of this rulemaking, § 620.4 now requires that each System institution prepare and send to FCA an electronic copy of its annual report. This amendment did not address filing requirements for the AMIS. We propose including this provision for the AMIS in new § 620.20 so that the filing requirements are consistent between the annual report and the AMIS.

We further propose adding language to paragraph (a)(3) of new § 620.20 explaining that an AMIS may be posted on an institution's Web site after the AMIS is mailed to shareholders. We propose requiring these postings be maintained on the institution's Web site for a reasonable amount of time, but at least 30 calendar days, to provide shareholders some certainty of time to view the posting. For example, if a posted AMIS addresses an upcoming director election, we would consider a reasonable amount of time to be the duration of the election cycle.

2. <u>Contents of the AMIS</u> [existing § 620.21]

We propose reorganizing existing § 620.21 to clarify the minimum information that must be included in an AMIS and the additional information that must be included in any AMIS issued in connection with elections.

a. <u>Minimum Requirements for Each AMIS</u> [§ 620.21(a)]

We propose keeping existing requirements that each AMIS include the date, time, and place of the meeting; the number of voting shareholders currently in the institution; updates to previously issued financial reports; changes or disagreements with external auditors; and the current composition and attendance history of the board of directors. While we make no changes to the substance of these existing requirements, we do propose some clarifications and additional requirements.

We propose incorporating notice of any online meeting space that might be used into the date, time, and place of meeting section of the AMIS. As explained earlier in the § 620.20 discussion, we propose requiring that the AMIS be issued no earlier than 30 business days in advance of a meeting or election, but no later than 10 business days in advance of the meeting.

We make no changes to how the AMIS identifies the number of voting shareholders, but propose moving the existing language in § 620.21(d)(3), addressing the number of shareholders voting by region, to this paragraph. We propose moving the requirement that each AMIS update financial information and report disagreements or changes in accountants to new paragraph (a)(3). We propose clarifying that the annual report being updated by the AMIS is the last annual report of record. This would clarify which annual report to reference when an institution holds an annual meeting before mailing the current year's annual report to shareholders.

We propose moving the requirement that institutions record the types of agriculture each incumbent director is engaged in from existing § 615.5230(b)(5) to paragraph (a)(4) of this section. We make the proposed change as part of our effort to consolidate our regulations and enhance clarity by keeping subject matters together.

We are not changing the existing requirement that director attendance be reported in the AMIS. However, we offer clarification of existing § 620.21(c)(2) on whether an institution is to disclose only the number of missed board meetings or the number of missed committee meetings in the director meeting attendance disclosure. The intention of the rule is to disclose any reduced attendance at meetings of official board business and thus the requirement to disclose missed meetings covers both board meetings and committee meetings. In providing this clarification, we propose no change to the current rule.

b. <u>Additional Information for Elections</u> [new § 620.21(b)]

i. <u>Director-Nominees</u> [new § 620.21(b)(1) and (b)(3)]

We propose moving to paragraph (b)(1) the existing § 620.21(d)(2) language on the efforts of the nominating committee to find two nominees for each vacant position. We then propose amending the provision to require that the names of the director-candidates nominated by the nominating committee be listed. This language captures the provision of existing § 620.21(d)(1) which, when moved to proposed § 611.330, loses the link to the nominating committee.

We propose moving to paragraph (b)(2) existing language requiring an AMIS to include director-nominee disclosures. We propose conforming changes to reference proposed § 611.330. As discussed earlier, the proposed creation of a new § 611.330, addressing the contents of director-nominee disclosures, involves moving those provisions from this section. The proposed creation of a separate director-nominee disclosure section does not remove the requirement of including those disclosures (or a restatement of them) in an election AMIS.

In another matter, we are aware that some institutions indicate on their ballots the director-candidates who are incumbent directors. While we are not proposing to amend the AMIS candidate disclosure requirement, we urge institutions to observe the principles of fairness and equal treatment of all director-candidates in providing disclosure information as stated in BL-056. We believe it is not necessary to indicate incumbency status on the ballots because all candidates provide disclosure statements with resume-type information and the incumbent's disclosure is likely to indicate past service on the institution board.

ii. <u>Floor Nominations</u> [new § 620.21(b)(3)]

We propose moving, but not changing, the existing requirement that institutions state whether floor nominations will be accepted. We are proposing that System institutions explain the procedures for making floor nominations. As discussed in section IV.E. of this preamble, institutions need to explain how voting shareholders can make floor nominations to ensure that the process works efficiently and effectively.

c. <u>Nominating Committees</u> [new §620.21(c)]

We propose adding a requirement in paragraph (c) that the election procedures for nominating committee candidates be included in the AMIS when nominating committees will be elected in connection with director elections. As in the election of directors, the election of members to the nominating committee is subject to each stockholder's right to a secret ballot under section 4.20 of the Act. We believe each institution must inform its voting shareholders of the procedures for voting on candidates for the nominating committee and must do so in a manner that protects each shareholder's right to a secret ballot.

K. <u>Other Miscellaneous Changes</u>

1. <u>Similar Entity Participation Lending Limit Voting</u> [§ 613.3300]

We propose clarifying § 613.3300(c)(1)(i)(B) to explain that the stockholder vote for participation lending limits is based on the majority of voting stockholders voting. The existing language does not specify how a majority vote is tabulated.

2. Equityholder Voting on Preferred Stock [§ 615.5230(b)]

We propose clarifying § 615.5230(b)(1) to explain that the equityholder vote on issuing preferred stock requires the approval of the majority of the shares voting of each class of equities adversely affected by the preference, voting as a class. The existing language does not specify that the majority is of the shares actually voted.

3. Definitions [existing § 620.1(p) and new § 619.9320]

We propose moving the definition of "shareholder" from part 620 to our general definition section at part 619. We also propose clarifying that the terms "shareholder" and "stockholder" have the same meaning for purposes of our rules. These two terms are currently used interchangeably in our rules as well as in the Act.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

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[1] Pub. L. 92-181, 85 Stat. 583.

[2] See sections 1.4, 2.1, 2.11, 3.2, 3.21, 7.1, 7.12 of the Act.

[3] "See Fletcher’s Cyclopedia of Corporations § 2013(emphasis added).

[4] A proxy is an authorization to act for a voting stockholder and requires the stockholder issuing the proxy to name a director or another voting stockholder of his or her choosing to cast that stockholder's vote.

[5] See 71 FR 5740, 5753 (February 2, 2006).

[6] Section 4.15 of the Act requires System associations to accept floor nominations, but does not have a similar requirement for Farm Credit banks.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

12 CFR Part 613

Agriculture, Banks, banking, Credit, Rural areas.

12 CFR Part 615

Accounting, Agriculture, Banks, banking, Government securities, Investments, Rural areas.

12 CFR Part 619

Agriculture, Banks, banking, Rural areas.

12 CFR Part 620

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

For the reasons stated in the preamble, parts 611, 613, 615, 619, and 620 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 611--ORGANIZATION

1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.3, 1.4, 1.13, 2.0, 2.1, 2.10, 2.11, 3.0, 3.2, 3.21, 4.12, 4.12A, 4.15, 4.20, 4.21, 5.9, 5.10, 5.17, 6.9, 6.26, 7.0-7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2011, 2012, 2021, 2071, 2072, 2091, 2092, 2121, 2123, 2142, 2183, 2184, 2203, 2208, 2209, 2243, 2244, 2252, 2278a-9, 2278b-6, 2279a-2279f-1, 2279aa-5(e)); secs. 411 and 412 of Pub. L. 100-233, 101 Stat. 1568, 1638; secs. 409 and 414 of Pub. L. 100-399, 102 Stat. 989, 1003, and 1004.

2. Add a new subpart A, consisting of §§ 611.100 through 611.120, to read as follows:

Subpart A--General

Sec.
611.100 Definitions.
611.110 Meetings of stockholders.
611.120 Quorums.

Subpart A--General

§ 611.100 Definitions.

The following definitions apply for the purpose of this part:

(a) *Mail ballot* means a ballot cast by mail or by electronic means after the conclusion of a stockholders' meeting.

(b) *Online meeting* means a meeting that is conducted over the Internet through the use of mediating technologies, such as online services, computer hardware and software, etc., where technology is used to generate objects and environments that are presented to users through a number of senses (e.g., vision and hearing). The mediating technologies allow remote people or objects to appear locally present or at least allow them to be treated that way during the course of the meeting.

(c) _Online meeting space_ means an online environment where Farm Credit institutions can hold stockholder meetings that allow stockholders to communicate, collaborate, and share information. Any stockholder with the necessary technology requirements and access (e.g., password-protected meetings) must be allowed to connect to his or her institution's online meeting space.

(d) _Quorum_ means the minimum number of voting stockholders of a Farm Credit institution that must be present, either in person (including through an online medium) or by proxy, at an annual meeting or other meeting of stockholders in order for the institution to conduct business.

(e) _Regional election_ means the apportionment of a Farm Credit institution's territory into regions in which a director or directors from a region are elected only by those voting stockholders who reside or conduct agricultural or aquatic operations in that same region.

(f) _Stockholder-association_ means an association within a Farm Credit bank district holding voting stock in that bank.

(g) _Stockholder-elected director_ means a director who is elected by the majority vote of the voting stockholders voting to serve as a member of a Farm Credit institution's board of directors.

§ 611.110 Meetings of stockholders.

(a) _Requirement._ Associations must annually have a meeting of stockholders for the purpose of conducting annual director elections. Associations must elect at least one director at each annual meeting, but the vote on the election of a director or directors may occur in the period following an annual meeting if voting is solely by mail ballots. Farm Credit banks are encouraged to hold annual or periodic meetings of stockholders. Farm Credit banks and associations may use an online meeting space in addition to a physical meeting space to conduct a stockholders' meeting or director elections. A physical meeting space must always exist for meetings involving director elections.

(b) _Notice._ Each Farm Credit bank and association must issue an Annual Meeting Information Statement in accordance with the requirements of §§ 620.20 and 620.21 of this chapter to notify stockholders of the date, time, and place of annual meetings or director elections. If a Farm Credit bank or association uses an online meeting space to conduct part of its meeting, the notice must specify the date, time, and location of the online meeting as well. The notice must be provided at least 10 business days, but no more than 30 business days, before the meeting.

(c) _Online meeting._ Each Farm Credit bank and association using an online meeting space as part of a meeting or election must have policies and procedures in place addressing how the online meeting space will be accessed and used by participants. The policies and procedures must specifically identify any technological adaptations necessary to address the confidentiality and security in voting requirements of § 611.340.

(d) _Attendance._ Each institution must encourage stockholder attendance at the annual meeting, whether in person or through online meeting attendance.

§ 611.120 Quorums.

(a) The bylaws of each Farm Credit bank and association must specify the quorum requirements for stockholder meetings.

(b) After January 1, 2011, mail ballots may not be used to establish a quorum. Proxy ballots and attendance at annual meetings or sectional sessions thereof, including such meetings held online, may be used to establish a quorum.

Subpart C--Election of Directors and Other Voting Procedures

3. Amend § 611.310 by revising paragraph (b) and adding new paragraphs (e) and (f) to read as follows:

§ 611.310 Eligibility for membership on bank and association boards and subsequent employment.
* * * * *

(b) No bank or association director shall be eligible to continue to serve in that capacity and his or her office shall become vacant if after election as a member of the board, he or she becomes legally incompetent or is convicted of any criminal offense involving dishonesty or breach of trust or held liable in damages for fraud.
* * * * *

(e) No person shall be eligible for membership on a Farm Credit bank or association board of directors in the same election cycle for which the Farm Credit institution's nominating committee is identifying candidates if that person was elected to serve on that institution's nominating committee and attended any meetings called by the nominating committee.

(f) Out-of-territory borrowers who hold voting stock in the association may serve as association directors unless prohibited by the association's bylaws. Associations must inform, in writing, each out-of-territory borrower of his or her eligibility status for directorship at the time the loan is made.

4. Amend § 611.320 by:

a. Removing the word "System" and adding the words "Farm Credit" each place it appears in paragraphs (a) and (d);

b. Revising paragraphs (c) and (e); and

c. Adding a new paragraph (f) to read as follows:

§ 611.320 Impartiality in the election of directors.
* * * * *

(c) No property, facilities, or resources, including information technology and human or financial resources, of any Farm Credit institution shall be used by any candidate for nomination or election or by any other person for the benefit of any candidate for nomination or election, unless the same property, facilities, or resources are simultaneously available and made known to be available for use by all declared candidates, including floor nominees. For the limited purpose of Farm Credit bank board elections, each stockholder-association of a Farm Credit bank may, to the extent permitted by the affiliated Farm Credit bank's policies and procedures, use its property, facilities, or resources in support of bank director-candidates. Each Farm Credit bank permitting this activity must establish reasonable standards that stockholder-associations must follow when using property, facilities, and resources for the nomination or election of candidates to the bank board. The Farm Credit bank's policies and procedures must give appropriate consideration to the various sizes of stockholder-associations within a bank's district and include a maximum amount that a stockholder-association may expend in support of a bank director-candidate.
* * * * *

(e) No Farm Credit institution may in any way distribute or mail, whether at the expense of the institution or another, any campaign materials for director-candidates. Institutions may request biographical information, as well as the disclosure information required under § 611.330, from all declared candidates who certify that they are eligible, restate such information in a standard format, and distribute or mail it with ballots or proxy ballots.

(f) No director of a Farm Credit institution shall make any statement, either orally or in writing, which may be construed as intended to influence any vote in that institution's director nominations or elections. This paragraph shall not prohibit director-candidates from engaging in campaign activities on their own behalf.

5. Revise § 611.325 to read as follows:

§ 611.325 Bank and association nominating committees.

Each Farm Credit bank and association may have only one nominating committee in any one election cycle. Each Farm Credit bank and association must establish and maintain policies and procedures on its nominating committee, describing the formation, composition, operation, resources, and duties of the committee, consistent with current laws and regulations. Each nominating committee must conduct itself in the impartial manner prescribed by the policies and procedures adopted by its institution under § 611.320 and this section.

(a) *Composition*. The voting stockholders of each bank and association must elect a nominating committee of no fewer than three members. Unless prohibited by association bylaws, out-of-territory borrowers who are voting stockholders may serve as members of an association's nominating committee. Each association must inform, in writing, an out-of-territory borrower of his or her eligibility to serve on the nominating committee at the time the loan is made.

(b) *Election*. Farm Credit banks and associations may use in-person (including use of an online medium) or mail balloting procedures to elect a nominating committee.

(1) Farm Credit banks and associations must provide voting stockholders the opportunity to vote on each nominee for membership on the nominating committee. Farm Credit banks and associations may give voting stockholders the option to vote on a slate of nominees for the nominating committee as long as the right to vote on individual nominees remains.

(2) Association nominating committee members may only be elected to a 1-year term. Farm Credit Banks must use weighted voting, with no cumulative voting permitted, when electing members to serve on a nominating committee.

(c) *Conflicts of interest*. No individual may serve on a nominating committee who, at the time of election to, or during service on, a nominating committee, is an employee, director, or agent of that bank or association. A nominating committee member may not be a candidate for election to the board in the same election for which the committee is identifying nominees. A nominating committee member may resign from the committee to run for election to the board only if the individual did not attend any nominating committee meeting.

(d) *Responsibilities*. It is the responsibility of each nominating committee to identify, evaluate, and nominate candidates for stockholder election to a Farm Credit bank or association board of directors. A nominating committee's responsibilities are limited to the following:

(1) Nominate individuals whom the committee determines meet the eligibility requirements to run for open director positions. The committee must endeavor to ensure representation from all areas of the Farm Credit bank's or association's territory and, as nearly as possible, all types of agriculture practiced within the territory.

(2) Evaluate the qualifications of the director-candidates. The evaluation process must consider whether there are any known obstacles preventing a candidate from performing the duties of the position.

(3) Nominate at least two candidates for each director position being voted on by stockholders. If two nominees cannot be identified, the nominating committee must provide written explanation to the existing board of the efforts to locate candidates or the reasons for disqualifying any other candidate that resulted in fewer than two nominees.

(4) Maintain records of its meetings, including a record of attendance at meetings.

(e) *Resources*. Each Farm Credit bank and association must provide its nominating committee reasonable access to administrative resources in order for the committee to perform its duties. Each Farm Credit bank and association must, at a minimum, provide its nominating committee with FCA regulations and guidance on nominating committees, a current list of stockholders, the most recent bylaws, the current director qualifications policy, and a copy of the policies and procedures that the bank or the association has adopted pursuant to § 611.320(a) ensuring impartial elections. On the request of the nominating committee, the institution must also provide a summary of the current board self-evaluation. The bank or association may require a pledge of confidentiality by committee members prior to releasing evaluation documents.

6. Add a new § 611.326 to subpart C to read as follows:

§ 611.326 <u>Floor nominations for open Farm Credit bank and association director positions</u>.

(a) Each floor nominee must be eligible for the director position for which the person has been nominated.

(b) Voting stockholders of associations must be allowed to make floor nominations for every open stockholder-elected director position. Associations using only mail ballots must allow nominations from the floor at every session of an annual meeting. Associations permitting stockholders to cast votes during annual meetings may only allow nominations from the floor at the first session of the annual meeting. Before every director election by a Farm Credit bank, the bank must inform voting stockholders whether floor nominations will be accepted.

(c) Each association must adopt policies and procedures for making and accepting floor nominations of candidates to stand for election to the association's board of directors. Farm Credit banks allowing nominations from the floor must also adopt policies and procedures for making and accepting floor nominations. Policies and procedures for floor nominations must, at a minimum, provide that:

(1) Floor nominations may only be made after the nominating committee has provided its list of director-nominees.

(2) No more than a second by a voting stockholder to a nomination from the floor is required. After receiving a floor nomination, the floor nominee must state if he or she accepts the nomination.

(3) Floor nominees must make the disclosures required by § 611.330 of this part.

7. Revise § 611.330 to read as follows:

§ 611.330 <u>Disclosures of Farm Credit bank and association director-nominees</u>.

(a) Each Farm Credit bank and association must adopt policies and procedures that ensure a disclosure statement is prepared by each director-nominee. At a minimum, each disclosure statement for each nominee must:

(1) State the nominee's name, city and state of residence, business address if any, age, and business experience during the last 5 years, including each nominee's principal occupation and employment during the last 5 years.

(2) List all business interests on whose board of directors the nominee serves or is otherwise employed in a position of authority and state the principal business in which the business interest is engaged.

(3) Identify any family relationship of the nominee that would be reportable under part 612 of this chapter if elected to the institution's board.

(b)(1) Floor nominees who are not incumbent directors must provide to the Farm Credit bank or association the information referred to in this section and in § 620.5(j) and (k) of this chapter. The information must be provided in either paper or electronic form within the time period prescribed by the institution's bylaws or policies and procedures. If the institution does not have a prescribed time period, each floor nominee must provide this information to the institution within 5 business days of the nomination. If stockholders will not vote solely by mail ballot upon conclusion of the meeting, each floor nominee must provide the information at the first session at which voting is held.

(2) For each nominee who is not an incumbent director or a nominee from the floor, the nominee must provide the information referred to in this section and in § 620.5(j) and (k) of this chapter.

(c) Each Farm Credit bank and association must distribute director-nominee disclosure information to all stockholders eligible to vote in the election. Institutions may either restate such information in a standard format or provide complete copies of each nominee's disclosure statement.

(1) Disclosure information for each director-nominee must be provided as part of the Annual Meeting Information Statement issued for director elections.

(2) Disclosure information for each director-nominee must be distributed or mailed with ballots or proxy ballots. Farm Credit banks and associations must ensure that the disclosure information on floor nominees is provided to voting stockholders by delivering ballots for the election of directors in the same format as the comparable information contained in the Annual Meeting Information Statement.

(d) No person may be a nominee for director who does not make the disclosures required by this section.

8. Add a new § 611.335 to subpart C to read as follows:

§ 611.335 Regional voting in director elections.

(a) *Authority*. The use of regional voting in director elections requires a bylaw provision approved by a majority of voting stockholders, voting in person or by proxy. The use of regional voting in director elections does not prevent any voting stockholder, regardless of the region where he or she resides or conducts agricultural or aquatic operations, from voting in any stockholder vote to remove a director.

(b) *Region size*. When using regional voting in director elections, there must be an approximately equal number of voting stockholders in each of the voting regions. Regions will have an approximately equal number of voting stockholders if the number of voting stockholders in any one region does not exceed the number of voting stockholders in any other region by more than 25 percent. At least once every 3 years, the number of voting stockholders in each region must be counted and, if the regions do not have an approximately equal number of voting stockholders, the regional boundaries must be adjusted to achieve such result. If more than one director represents a region, the equitability of regions shall be determined by dividing the number of voting stockholders in that region by the number of director positions representing that region, and the resulting quotient shall be the number that is compared to the number of voting stockholders in other regions.

9. Revise §§ 611.340 and 611.350 to read as follows:

§ 611.340 Confidentiality and security in voting.

(a) Each Farm Credit bank and association must adopt policies and procedures that:

(1) Ensure the security of all records and materials related to a stockholder vote including, but not limited to, ballots, proxy ballots, and other related materials.

(2) Ensure that ballots and proxy ballots are provided only to stockholders who are eligible to vote as of the record date set for the stockholder vote.

(3) Ensure that all information and materials regarding how or whether an individual stockholder has voted remain confidential, including protecting the information from disclosure to the institution's directors, stockholders, or employees, or any other person except:

(i) An independent third party tabulating the vote; or

(ii) The Farm Credit Administration.

(4) Provide for the establishment of a tellers committee or independent third party who will be responsible for validating ballots and proxies and tabulating voting results. A tellers committee may only consist of voting stockholders who are not directors, director-nominees, or members of that election cycle's nominating committee.

(b) No Farm Credit bank or association may use signed ballots in stockholder votes. A bank or association may use balloting procedures, such as an identity code on the ballot, that can be used to identify how or whether an individual stockholder has voted only if the votes are tabulated by an independent third party. In weighted voting, the votes must be tabulated by an independent third party. An independent third party that tabulates the votes must certify in writing that such party will not disclose to any person (including the institution, its directors, stockholders, or employees) any information about how or whether an individual stockholder has voted, except that the information must be disclosed to the Farm Credit Administration if requested.

(c) Once a Farm Credit bank or association receives a ballot, the vote of that stockholder is final, except that a stockholder may withdraw a proxy ballot before balloting begins at a stockholders' meeting. A Farm Credit bank or association may give a stockholder voting by proxy an opportunity to give voting discretion to the proxy of the stockholder's choice, provided that the proxy is also a stockholder eligible to vote.

(d) Ballots and proxy ballots must be safeguarded before the time of distribution or mailing to voting stockholders and after the time of receipt by the bank or association until disposal. When stockholder meetings are held for the purpose of conducting elections or other votes, only proxy ballots may be accepted prior to any or all sessions of the stockholders' meeting. In an election of directors, ballots, proxy ballots and election records must be retained at least until the end of the term of office of the director. In other stockholder votes, ballots, proxy ballots, and records must be retained for at least 3 years after the vote.

(e) An institution and its officers, directors, and employees may not make any public announcement of the results of a stockholder vote before the tellers committee or independent third party has validated the results of the vote.

§ 611.350 Application of cooperative principles to the election of directors.

In the election of directors, each Farm Credit institution shall comply with the following cooperative principles as well as those set forth in § 615.5230 of this chapter, unless otherwise required by statute or regulation.

(a) Each voting stockholder of an association or bank for cooperatives has only one vote, regardless of the number of shares owned or the number of loans outstanding. Each voting stockholder-association of a Farm Credit Bank has only one vote that is assigned a weight proportional to the number of that association's voting stockholders. Each voting stockholder of an agricultural credit bank has only one vote, unless otherwise approved by the Farm Credit Administration.

(b) Each voting stockholder must be accorded the right to vote in the election of each stockholder-elected director, unless regional voting in director elections is provided for in the institution's bylaws. When electing directors by regions, pursuant to § 611.335, each voting stockholder must be accorded the right to vote in the election of each stockholder-elected director for their region.

(c) If the association apportions its territory into geographic regions for director nomination or election purposes, out-of-territory voting stockholders must be assigned to a geographic region.

(d) Each voting stockholder of a Farm Credit institution must be allowed to cumulate votes and distribute them among the director-nominees at the stockholder's discretion unless otherwise provided in the bylaws or in the case of regional voting in director elections. Cumulative voting is not allowed in the regional voting of directors. A Farm Credit Bank may eliminate cumulative voting if 75 percent of the associations that are voting stockholders of the Farm Credit Bank vote in favor of elimination. In a vote to eliminate cumulative voting, each association shall be accorded one vote that is not a weighted vote.

(e) All voting stockholders of a Farm Credit institution have the right to vote in any stockholder vote to remove any director.

Subpart P--Termination of System Institution Status

10. Revise § 611.1240(e) to read as follows:

§ 611.1240 Voting record date and stockholder approval.

*** * * * ***

(e) *Voting procedures.* The voting procedures must comply with § 611.340. You must have an independent third party count the ballots. If a voting stockholder notifies you of the stockholder's intent to exercise dissenters' rights, the tabulator must be able to verify to you that the stockholder voted against the termination. Otherwise, the votes of stockholders must remain confidential.

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PART 613--ELIGIBILITY AND SCOPE OF FINANCING

11. The authority citation for part 613 continues to read as follows:

Authority: Secs. 1.5, 1.7, 1.9, 1.10, 1.11, 2.2, 2.4, 2.12, 3.1, 3.7, 3.8, 3.22, 4.18A, 4.25, 4.26, 4.27, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2017, 2018, 2019, 2073, 2075, 2093, 2122, 2128, 2129, 2143, 2206a, 2211, 2212, 2213, 2243, 2252).

Subpart C--Similar Entity Authority Under Sections 3.1(11)(B) and 4.18A of the Act

§ 613.3300 [Amended]

12. Amend § 613.3300(c)(1)(i)(B) by removing the words "if a majority of the shareholders" and adding in their place the words "if a majority of voting stockholders voting".

PART 615--FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

13. The authority citation for part 615 continues to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 6.20, 6.26, 8.0, 8.3, 8.4, 8.6, 8.7, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2278b, 2278b-6, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-7, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a) of Pub. L. 100-233, 101 Stat. 1568, 1608.

Subpart I--Issuance of Equities

14. Amend § 615.5230 by revising paragraphs (a) and (b)(1) and by removing paragraph (b)(5) to read as follows:

§ 615.5230 Implementation of cooperative principles.

(a) Voting stockholders of Farm Credit banks and associations shall be accorded full voting rights in accordance with cooperative principles. Except as otherwise required by statute or regulation and except as modified by paragraph (b) of this section, the voting rights of each voting stockholder are as follows:

(1) Each voting stockholder of an association or bank for cooperatives has only one vote, regardless of the number of shares owned or the number of loans outstanding.

(2) Each voting stockholder-association of a Farm Credit Bank has only one vote that is assigned a weight proportional to the number of that association's voting stockholders.

(3) Each voting stockholder of an agricultural credit bank has only one vote unless otherwise approved by the Farm Credit Administration.

(b) * * *

(1) Each issuance of preferred stock (other than preferred stock outstanding on October 5, 1988, and stock into which such outstanding stock is converted that has substantially similar preferences) shall be approved by a majority of the shares voting of each class of equities adversely affected by the preference, voting as a class, whether or not such classes are otherwise authorized to vote;

*** * * * ***

PART 619--DEFINITIONS

15. The authority citation for part 619 is revised to read as follows:

Authority: Secs. 1.4, 1.7, 2.1, 2.4, 2.11, 3.2, 3.21, 4.9, 5.9, 5.17, 5.18, 5.19, 7.0, 7.1, 7.6, 7.8 and 7.12 of the Farm Credit Act (12 U.S.C. 2012, 2015, 2072, 2075, 2092, 2123, 2142, 2160, 2243, 2252, 2253, 2254, 2279a, 2279a-1, 2279b, 2279c-1, 2279f).

16. Amend part 619 by adding new § 619.9320 to read as follows:

§ 619.9320 Shareholder or stockholder.
A holder of any equity interest in a Farm Credit institution.

PART 620--DISCLOSURE TO SHAREHOLDERS

17. The authority citation for part 620 continues to read as follows:

Authority: Secs. 4.19, 5.9, 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2207, 2243, 2252, 2254, 2279aa-11); sec. 424 of Pub. L. 100-233, 101 Stat. 1568, 1656.

Subpart A--General

§ 620.1 [Amended]

18. Amend § 620.1 by removing paragraph (p) and redesignating paragraphs (q) and (r) as paragraphs (p) and (q).

Subpart E--Annual Meeting Information Statement

19. Revise the heading of subpart E to read as follows:

Subpart E--Annual Meeting Information Statements and Other Information to be Furnished in Connection with Annual Meetings and Director Elections

20. Amend subpart E by adding a new § 620.20 to read as follows:

§ 620.20 Preparing and distributing the information statement.
(a)(1) Each Farm Credit bank and association must prepare and provide an information statement ("statement" or "AMIS") to its shareholders at least 10 business days, but no more than 30 business days, before any annual meeting or any director elections.
(2) Each Farm Credit bank and association must provide to the Farm Credit Administration an electronic copy of the AMIS when issued.
(3) In addition to the mailed AMIS, each Farm Credit bank and association may post its AMIS on its Web site. Any AMIS posted on an institution's Web site must remain on the Web site for a reasonable period of time, but not less than 30 calendar days.
(b) Every AMIS must be dated and signed in accordance with the requirements of § 620.3(b) of this part.
(c) Every AMIS must be available for public inspection at all offices of the issuing institution pursuant to § 620.2(b) of this part.

21. Amend § 620.21 by revising the heading, removing the introductory text, and revising paragraphs (a) through (d) to read as follows:

§ 620.21 Contents of the information statement.

(a) An AMIS must, at a minimum, address the following items:

(1) *Date, time, and place of the meeting(s).* Notice of the date, time, and meeting location(s) must be provided at least 10 business days, but no more than 30 business days, before the meeting. If the Farm Credit bank or association will use an online meeting space as part of its meeting, the notice must also specify the date, time, and means of accessing the online meeting space.

(2) *Voting shareholders.* For each class of stock entitled to vote at the meeting, state the number of shareholders entitled to vote and, when shareholders are asked to vote on preferred stock, the number of shares entitled to vote. State the record date as of which the shareholders entitled to vote will be determined and the voting requirements for each matter to be voted upon. If directors are nominated or elected by region, describe the regions and state the number of voting shareholders entitled to vote in each region.

(3) *Financial updates.* Each AMIS must reference the most recently issued annual report required by subpart B of this part. The AMIS must also include such other information considered material and necessary to make the required contents of the AMIS, in light of the circumstances under which it is made, not misleading.

(i) If any transactions between the institution and its senior officers and directors of the type required to be disclosed in the annual report to shareholders under § 620.5(j), or any of the events required to be disclosed in the annual report to shareholders under § 620.5(k) have occurred since the end of the last fiscal year and were not disclosed in the annual report to shareholders, the disclosures required by § 620.5(j) and (k) shall be made with respect to such transactions or events in the information statement. If any material change in the matters disclosed in the annual report to shareholders pursuant to § 620.5(j) and (k) has occurred since the annual report to shareholders was prepared, disclosure shall be made of such change in the information statement.

(ii) If the Farm Credit institution has had a change or changes in accountants since the last annual report to shareholders, or if a disagreement with an accountant has occurred, the institution shall disclose the information required by § 621.4(c) and (d) of this chapter.

(4) *Directors.* State the names and ages of persons currently serving as directors of the institution, their terms of office, and the periods during which such persons have served. Institutions must also state the type or types of agriculture or aquaculture engaged in by each director. No information need be given with respect to any director whose term of office as a director will not continue after the meeting to which the statement relates.

(i) Identify by name any incumbent director who attended fewer than 75 percent of the board meetings or any meetings of board committees on which he or she served during the last fiscal year.

(ii) If any director resigned or declined to stand for re-election since the last annual meeting because of a policy disagreement with the board, and if the director has provided a notice requesting disclosure of the nature of the disagreement, state the date of the director's resignation and summarize the director's description of the disagreement. If the institution holds a different view of the disagreement, the institution's view may be summarized.

(b) An AMIS issued for director elections must also include the information required by this paragraph.

(1) Provide the nominating committee's slate of director-nominees. If fewer than two director-nominees for each position are named, describe the efforts of the nominating committee to locate two willing nominees.

(2) Provide, as part of the AMIS, each director-nominee's disclosure information collected under § 611.330 of this chapter. Institutions may either restate such information in a standard format or provide complete copies of each nominee's disclosure statement.

(3) State whether nominations will be accepted from the floor and explain the procedures for making floor nominations.

(c) When the nominating committee will be elected during director elections, notice to voting shareholders of this event must be included in the AMIS. The AMIS must describe the balloting procedures that will be used to elect the nominating committee, including whether floor nominations for committee members will be permitted. The AMIS must state the number of committee positions to be filled and the names of the nominees for the committee.

(d) If shareholders are asked to vote on matters not normally required to be submitted to shareholders for approval, the AMIS must describe fully the material circumstances surrounding the matter, the reason shareholders are asked to vote, and the vote required for approval of the proposition. The AMIS must describe any other matter that will be discussed at the meeting upon which shareholder vote is not required.

*** * * * ***

Dated: April 10, 2009

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

74 FR 23961, 05/22/2009

Handbook Mailing HM-09-2

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 613, 615, 619, and 620

RIN 3052-AC43

Organization; Eligibility and Scope of Financing; Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Definitions; and Disclosure to Shareholders; Director Elections

AGENCY: Farm Credit Administration**.**

ACTION: Notice of proposed rulemaking; extension of comment period.

SUMMARY: The Farm Credit Administration (FCA, Agency or we) is extending the comment period on our proposed rulemaking that seeks comments on proposed changes to the rules on Farm Credit System (System) bank and association director elections and other voting procedures to clarify the director elections process, and to update our rules to incorporate interpretations made through recent bookletters to System institutions. We are extending the comment period so all interested parties will have additional time to provide comments.

DATES: You may send comments on or before August 14, 2009.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Elna Luopa, Senior Corporate Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703)883-4498, TTY (703)883-4434;

or

Laura D. McFarland, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703)883-4020.

SUPPLEMENTARY INFORMATION: On April 16, 2009, FCA published a notice in the Federal Register seeking public comment on proposed changes to the rules governing director elections for System banks and associations and the related director elections process. See 74 FR 17612. The comment period is scheduled to expire on June 15, 2009. In a letter dated May 1, 2009, the Farm Credit Council, on behalf of System banks and associations, requested that the Agency extend the comment period for another 60 days to allow more time for the boards of directors of System banks and associations to consider the proposed rule and submit their comments. Several System associations submitted separate requests to extend the public comment period for an additional 60 days, noting that they will have only one board meeting at which to consider and discuss the issues before the comment period expires. Due to the wide-ranging effect of the proposed rule on directors, director candidates, nominating committees, and the voting shareholders of System institutions, we have granted this request. The FCA supports public involvement and participation in its regulatory process and invites all interested parties to review and provide comments on our proposed rule.

Dated: May 19, 2009

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

74 FR 27386, 06/09/2009

Handbook Mailing HM-09-3

[BILLING CODES: 4810-33-P 16.66%; 6210-01-P 16.66%; 6714-01-P 16.66%; 6720-01-P 16.66%; 6705-01-P 16.66%; 7535-01-P 16.66%]

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 34
Docket ID OCC-2009-0005
RIN 1557-AD23

FEDERAL RESERVE SYSTEM
12 CFR Part 208
Docket No. R-1357

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 365
RIN 3064-AD43

DEPARTMENT OF THE TREASURY
Office of Thrift Supervision
12 CFR Part 563
Docket No. 2009 - 0004
RIN 1550-AC33

FARM CREDIT ADMINISTRATION
12 CFR Part 610
RIN 3052-AC52

NATIONAL CREDIT UNION ADMINISTRATION
12 CFR Part 761
RIN 3133-AD59

Registration of Mortgage Loan Originators

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); Farm Credit Administration (FCA); and National Credit Union Administration (NCUA).

ACTION: Joint notice of proposed rulemaking.

SUMMARY: The OCC, Board, FDIC, OTS, FCA, and NCUA (collectively, the Agencies) are proposing amendments to their rules to implement the Secure and Fair Enforcement for Mortgage Licensing Act (the S.A.F.E. Act). The S.A.F.E. Act requires an employee of a bank, savings association,

credit union or other depository institution and their subsidiaries regulated by a Federal banking agency or an employee of an institution regulated by the FCA (collectively, Agency-regulated institutions) who acts as a residential mortgage loan originator to register with the Nationwide Mortgage Licensing System and Registry (Registry), obtain a unique identifier, and maintain this registration. This proposal implements these requirements. It also provides that Agency-regulated institutions must require their employees who act as residential mortgage loan originators to comply with the S.A.F.E. Act's requirements to register and obtain a unique identifier and must adopt and follow written policies and procedures designed to assure compliance with these requirements.

DATES: Comments must be received on or before July 9, 2009. Comments on the Paperwork Reduction Act analysis set forth in Part II of the Regulatory Analysis Section of this *Federal Register* notice must be received on or before August 10, 2009.

ADDRESSES: Commenters that direct comments to more than one Agency may send comments to any of the Agencies and need not send copies of the same comment letter to all of the Agencies. Commenters are encouraged to use the title "Registration of Mortgage Loan Originators" to facilitate the organization and distribution of comments among the Agencies. Interested parties are invited to submit written comments to:

- Office of the Comptroller of the Currency: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title "Registration of Mortgage Loan Originators" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:
- Federal eRulemaking Portal – "Regulations.gov": Go to http://www.regulations.gov, under the "More Search Options" tab click next to the "Advanced Docket Search" option where indicated, select "Comptroller of the Currency" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "OCC-2009-0005" to submit or view public comments and to view supporting and related materials for this proposal. The "How to Use This Site" link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- E-mail: regs.comments@occ.treas.gov.
- Mail: Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.
- Fax: (202) 874-5274.
- Hand Delivery/Courier: 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket Number OCC-2009-0005" in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this proposal by any of the following methods:

- Viewing Comments Electronically: Go to http://www.regulations.gov, under the "More Search Options" tab click next to the "Advanced Document Search" option where indicated, select "Comptroller of the Currency" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "OCC-2009-0005" to view public comments for this rulemaking action.

- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

- Docket: You may also view or request available background documents and project summaries using the methods described above.

Board of Governors of the Federal Reserve System:

You may submit comments, identified by Docket No. R-1357, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.

- Fax: (202) 452-3819 or (202) 452-3102.

- Mail: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551.

All public comments will be made available on the Board's web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

Federal Deposit Insurance Corporation: You may submit comments, identified by RIN number, by any of the following methods:

- Agency Web Site: http://www.FDIC.gov/regulations/laws/federal/notices.html. Follow instructions for submitting comments on the Agency Web Site.

- E-mail: Comments@FDIC.gov. Include the RIN number on the subject line of the message.

- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

- Hand Delivery**:** Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F. Street) on business days between 7 a.m. and 5 p.m.

  Instructions: All comments received must include the agency name and RIN for this rulemaking and will be posted without change to http://www.fdic.gov/regulations/laws/ federal/propose.html, including any personal information provided.

Office of Thrift Supervision: You may submit comments, identified by OTS-2009-0004, by any of the following methods:

- Federal eRulemaking Portal- "Regulations.gov": Go to http://www.regulations.gov, under the "more Search Options" tab click next to the "Advanced Docket Search" option where indicated, select "Office of Thrift Supervision" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "OTS-2009-0004" to submit or view public comments and to view supporting and related materials for this proposed rulemaking. The "How to Use This Site" link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- E-mail address: regs.comments@ots.treas.gov. Please include OTS-2009-0004 in the subject line of the message and include your name and telephone number in the message.

- Mail: Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552, Attention: OTS-2009-0004.

- Facsimile: (202) 906-6518.

- Hand Delivery/Courier: Guard's Desk, East Lobby Entrance, 1700 G Street, NW, from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: OTS-2009-0004.

- Instructions: All submissions received must include the agency name and docket number for this rulemaking. All comments received will be entered into the docket and posted on Regulations.gov without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

- Viewing Comments On-Site: You may inspect comments at the Public Reading Room, 1700 G Street, NW, by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

Farm Credit Administration:

We offer a variety of methods to receive your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site or the Federal eRulemaking Portal. As faxes are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.

- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of comments we received at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

National Credit Union Administration: You may submit comments by any of the following methods (please send comments by one method only):

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- NCUA Web Site: http://www.ncua.gov/RegulationsOpinionsLaws/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.

- E-mail: Address to regcomments@ncua.gov. Include "[Your name] Comments on Notice of Proposed Rulemaking Part 761, Registration of Mortgage Loan Originators " in the e-mail subject line.

- Fax: (703) 518-6319. Use the subject line described above for e-mail.

- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

- Hand Delivery/Courier: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration. Deliver to guard station in the lobby of 1775 Duke Street, Alexandria, VA 22314-3428, on business days between 8:00 a.m. and 5:00 p.m.

- Public inspection: All public comments are available on the agency's Web site at http://www.ncua.gov/RegulationsOpinionsLaws/comments as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library, at 1775 Duke Street, Alexandria, VA 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT:

OCC: Michele Meyer, Assistant Director, and Heidi Thomas, Special Counsel, Legislative and Regulatory Activities, (202) 874-5090, and Nan Goulet, Senior Advisor, Large Bank Supervision, (202) 874-5224, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

BOARD: Anne Zorc, Counsel, Legal Division, (202) 452-3876, Virginia Gibbs, Senior Supervisory Analyst, (202) 452-2521, and Stanley Rediger, Supervisory Financial Analyst, (202) 452-2629, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington , D.C. 20551

FDIC: Thomas F. Lyons, Examination Specialist, (202) 898-6850, Victoria Pawelski, Policy Analyst, (202) 898-3571, or John P. Kotsiras, Financial Analyst, (202) 898-6620, Division of Supervision and Consumer Protection; or Richard Foley, Counsel, (202) 898-3784, or Kimberly A. Stock, Counsel, (202) 898-3815, Legal Division; Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429.

OTS: Charlotte M. Bahin, Special Counsel (Special Projects), (202) 906-6452, Vicki Hawkins-Jones, Special Counsel, Regulations and Legislation Division, (202) 906-7034, Debbie Merkle, Project Manager, Credit Risk, (202) 906-5688, and Rhonda Daniels, Senior Compliance Program Analyst, Consumer Regulations, (202) 906-7158, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

FCA: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA, (703) 883-4414, TTY (703) 883-4434;
Richard A. Katz, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020; or Jennifer Cohn, Senior Counsel, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

NCUA: Regina Metz, Staff Attorney, Office of General Counsel, at the above address or 703-518-6561; or Roger Blake, Program Officer, Division of Supervision, Examination & Insurance, at the above address or 703-518-6385.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

A. Statutory Requirements

The S.A.F.E. Act,[1] enacted on July 30, 2008, mandates a nationwide licensing and/or registration system for mortgage loan originators. Specifically, the Act requires all States to provide for a licensing regime for mortgage loan originators within one year of enactment (or two years for States whose legislatures meet biennially) and prohibits an individual employed by a State-regulated institution from engaging in the business of residential mortgage loan origination without first obtaining and maintaining a license and registration and obtaining a unique identifier (State licensing).[2]

With respect to mortgage loan originators employed by Agency-regulated institutions, the Act requires the OCC, Board, FDIC, OTS and NCUA,[3] through the Federal Financial Institutions Examination Council (FFIEC), and the FCA to develop and maintain a Federal registration system, and to implement this system by July 29, 2009 (Federal registration). The S.A.F.E. Act specifically prohibits an individual employed by an Agency-regulated institution from engaging in the business of residential mortgage loan origination without first obtaining and maintaining annually a registration as a registered mortgage loan originator and obtaining a unique identifier. This rulemaking implements these requirements for Agency-regulated institutions.

The S.A.F.E. Act requires that Federal registration and State licensing and registration must be accomplished through the Registry. The S.A.F.E. Act provides that the objectives of the Registry, among other things, are to aggregate and improve the flow of information to and between regulators; provide increased accountability and tracking of mortgage loan originators; enhance consumer protections; reduce fraud in the residential mortgage loan origination process; and provide consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators.[4]

The S.A.F.E. Act specifically requires the Agencies to jointly develop and maintain a system for registering mortgage loan originators employed by Agency-regulated institutions with the Registry. In connection with this registration, the Agencies at a minimum must furnish or cause to be furnished to the Registry information concerning the mortgage loan originator's identity, including: (1) fingerprints for submission to the Federal Bureau of Investigation (FBI) and any other relevant governmental agency for a State and national criminal background check; and (2) personal history and experience, including authorization for the Registry to obtain information related to any administrative, civil, or criminal findings by any governmental jurisdiction.[5]

B. Implementing the Requirements for Federal Registration

The Registry is a web-based system developed and maintained by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR). The Registry was launched in January of 2008 for State licensing and registration purposes in participating States.[6] Mortgage loan originators in those States complete a single uniform form (known as the MU4) electronically. The data provided on the form is stored electronically in a secure, centralized repository available to State mortgage regulators who use it to process license applications and for supervisory purposes.

The Federal banking agencies, through the FFIEC, and the FCA are working with CSBS to modify the Registry so that it can accept registrations from mortgage loan originators employed by Agency-regulated institutions. As indicated above, the Registry currently supports the licensing of State mortgage lending institutions and their mortgage loan originators, a process that involves State authorization of individuals to engage in mortgage loan origination. It was not originally designed to support the Federal registration of Agency-regulated institution employees, who do not need additional authorization from the appropriate Federal agency to engage in mortgage loan origination activities. Furthermore, the S.A.F.E. Act requires new enhancements to the current system, such as public access to certain mortgage loan originator data and processing of fingerprints through the Registry. These differences between the current Registry and the Federal registration system required by the S.A.F.E. Act, as well as the resulting modifications necessary to support both State licensing and Federal registration functions, require careful analysis and raise complex legal and system development issues that the Agencies are addressing through both this rulemaking and modifications to the Registry. These issues include: consistency of data requirements for mortgage loan originators subject to Agency jurisdiction and those subject to State jurisdiction; modification to web-page navigation in the current system; registration functionality for the anticipated hundreds of thousands of Federal registrants; Federal procurement and contracting issues; data privacy and security requirements; and protocols for submitting mortgage loan originators' fingerprints to the FBI. Furthermore, the modified system is expected to support mortgage loan originators who move between the Federal registration and the State licensing regimes due to employment changes or who are licensed under one or more State regimes and also registered under the Federal regime.[7] The Agencies and CSBS have made substantial progress in resolving these issues, and the Agencies expect to enter into an agreement with the Registry that will provide for appropriate consultation between the Agencies and the Registry concerning registrant information requirements and fees, system functionality and security, and other operational matters. However, final determination of system costs, funding, design, development and deployment will not be completed until after the Agencies adopt a final rule establishing registration requirements.

This proposal provides for a 180-day period within which to complete initial registrations after the Registry is capable of accepting registrations from employees of Agency-regulated institutions. During this period, employees of Agency-regulated institutions would not be subject to sanctions if they originate residential mortgage loans without having completed their registration. The Agencies expect that this time period would provide mortgage loan originators and the Agency-regulated institutions that employ them adequate opportunity to prepare for the registrations required under this proposal. The Agencies intend to make a formal public announcement, in advance, of the date when the Registry will begin accepting registrations from employees of Agency-regulated institutions.

When fully operational, mortgage loan originators and their Agency-regulated institution employers are expected to have access to the Registry, seven days a week, to establish and maintain their registrations. Furthermore, the CSBS plans to phase-in system enhancements to provide consumers with access to certain information from the Registry in order for them to obtain information on State-licensed and Federally-registered mortgage loan originators.

As indicated above, and consistent with the S.A.F.E. Act, the Registry will not screen or approve registrations received from employees of Agency-regulated institutions. Instead, it will be the repository of, and conduit for, information on those employees who are mortgage loan originators at Agency-regulated institutions. As provided in § ___.104(d) and (h) of the proposed rule, it will be the responsibility of the Agency-regulated institution to review its employees' submissions as well as any reports received from the Registry.

II. OVERVIEW OF THE PROPOSAL

The proposed rule implements the S.A.F.E. Act's requirements with respect to Agency-regulated institutions. It requires individuals employed by these institutions who act as mortgage loan originators to register with the Registry, obtain unique identifiers, and maintain their registrations. The proposal also directs Agency-regulated institutions to require compliance with these requirements. Furthermore, the proposal requires Agency-regulated institutions to adopt and follow written policies and procedures to assure such compliance.

A detailed section-by-section description of this proposal with a request for comments is set forth below.

III. SECTION-BY-SECTION DESCRIPTION OF THE PROPOSED RULE

Section ___.101 – Authority, purpose, and scope

Section ____.101[8] states that this rule implements the S.A.F.E. Act's Federal registration requirements, which apply to individuals who originate residential mortgage loans, and describes the objectives of the S.A.F.E. Act's registration mandate. This section also identifies the entities that employ individual mortgage loan originators – entities referred to in this preamble discussion as Agency-regulated institutions – and that also are covered by this proposal. Under the S.A.F.E. Act, a mortgage loan originator must be Federally-registered if that individual is an employee of a depository institution, an employee of any subsidiary owned and controlled by a depository institution and regulated by a Federal banking agency, or an employee of an institution regulated by the FCA. Collectively, the Agencies' proposed rule applies to a depository institution, any subsidiary of a depository institution that is regulated by a Federal banking agency, and an institution regulated by the FCA. Section 1503(2) of the S.A.F.E. Act provides that "depository institution" has the same meaning as in section 3 of the Federal Deposit Insurance Act (FDI Act),[9] and includes any credit union. The Agencies note that because the definition of "depository institution" in the FDI Act and in the S.A.F.E. Act does not include bank or savings association holding companies or their non-depository subsidiaries, employees of these entities who act as mortgage loan originators are not covered by the Federal registration requirement and, therefore, must comply with State registration and licensing requirements.

Each Agency's proposed rule indicates the specific entities covered by the proposal. With respect to the OCC, this rule applies to national banks, Federal branches and agencies of foreign banks, their operating subsidiaries, and their employees who are mortgage loan originators.[10] For the Board, this rule applies to member banks of the Federal Reserve System (other than national banks), their respective subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)(5)); and branches and agencies of foreign banks (other than Federal branches, Federal agencies and insured State branches of foreign banks) and commercial lending companies owned or controlled by foreign banks[11] and their employees who act as mortgage loan originators. For the FDIC, this rule applies to insured State nonmember banks (including State-licensed insured branches of foreign banks) and their subsidiaries (except brokers, dealers, persons providing insurance, investment companies, and investment advisers) and their employees who are mortgage loan originators. For the OTS, this rule applies to savings associations and their operating subsidiaries, and their employees who are mortgage loan originators. For the FCA, this rule applies to Farm Credit System (FCS or System) institutions that originate residential mortgage loans under sections 1.9(3), 1.11 and 2.4(a)(2) and (b) of the Farm Credit Act of 1971, as amended, 12 U.S.C. 2017(3), 2019, and 2075(a)(2) and (b), and their employees who are mortgage loan originators.[12] For the NCUA, this rule applies to federally-insured credit unions and their employees who are mortgage loan originators.

Section 1507 of the S.A.F.E. Act requires the Federal banking agencies to make such de minimis exceptions "as may be appropriate" to the Act's requirements to register and obtain a unique identifier.[13] Section ___.101(c)(2) of the proposed rule states that these registration requirements do not apply to an employee of an Agency-regulated institution if during the last 12 months: (1) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and (2) the Agency-regulated institution employs mortgage loan originators who, while excepted from registration pursuant to this section, in the aggregate, acted as a mortgage loan originator in connection with 25 or fewer residential mortgage loans.[14] An employee must register with the Registry prior to engaging in mortgage loan origination activity that exceeds either the individual or aggregate limit. The Agencies solicit comment on whether the proposed exception adequately and appropriately covers circumstances that are truly de minimis and whether any de minimis exception is appropriate.[15]

In addition, the Agencies specifically invite comment on: whether the individual and institution-wide limits on the number of residential mortgage loans for which employees may act as a mortgage loan originator without registering and obtaining a unique identifier are appropriate; whether the proposed exception is adequately structured to prevent manipulation or "gaming" of the registration requirements; whether an institution should aggregate its residential mortgage loans with its subsidiaries when calculating the number of mortgage loans originated for purposes of this exception; whether monitoring for compliance with the proposed exception would be unduly burdensome for Agency-regulated institutions, and if so, how such burden could be minimized; and whether the proposed exception is consistent with the consumer protection and fraud prevention purposes of the S.A.F.E. Act.

The Agencies also solicit comment on whether an asset-based threshold is appropriate or whether other types of limits or thresholds, or other ways of structuring a de minimis exception, would be more appropriate. For example, should the proposed de minimis exception be applicable only to Agency-regulated institutions with total assets that do not exceed the amount that the Board establishes annually for banks, savings associations, and credit unions as an exception from the Home Mortgage Disclosure Act (HMDA)?[16]

Furthermore, please provide comment on whether alternatively, or in addition to the foregoing, a de minimis exception should be crafted to be event specific. For example, a de minimis exception might provide that the registration requirements would not apply to an employee who does not regularly function as a mortgage loan originator and who originates no more than a small number of loans within a 12-month period during the absence (such as vacation or illness) of the individual that regularly functions as the Agency-regulated institution's mortgage loan originator.

The Agencies note that the de minimis exception contained in the proposed rule would be voluntary; it would not prevent a mortgage loan originator who meets the criteria for the exception from registering with the Registry if the originator chooses to do so or if his or her employer requires registration.

Section ___.102 - Definitions

Section ___.102 defines the various terms used in the proposal. If a term is defined in the S.A.F.E. Act, the proposal generally incorporates that definition. The proposal has adopted other definitions used by the Registry in order to promote consistency and comparability, insofar as is feasible, between Federal registration requirements and the States' licensing requirements.

Annual renewal period. The proposal requires that a mortgage loan originator renew his or her registration annually during the annual renewal period. The annual renewal period is November 1 through December 31 of each calendar year and a registered mortgage loan originator must renew during this period regardless of the date of the initial registration. For example, an employee who registered in October 2010 would have to renew between November 1, 2010 and December 31, 2010. This is the same annual renewal period provided to State mortgage loan originators by the Registry. However, the Agencies and the Registry are discussing whether an alternate annual renewal period for Agency-regulated institutions at a different time of year from the annual renewal period of the State mortgage loan originators may be more desirable from a technical and operational standpoint. For example the final rule may designate the annual renewal period during another two-month time period during the year instead of the proposed renewal period. Furthermore, the Agencies are considering whether the rule should provide for a method in which the rule's registration requirements may be temporarily waived, or the initial registration or renewal period extended, in case of emergency, systems malfunction, or other event beyond the control of the Agency-regulated institution or the mortgage loan originator.

Mortgage loan originator. The proposed definition of "mortgage loan originator" is based on the definition of the term "loan originator" included in the S.A.F.E. Act at section 1503(3). Specifically, this term means an individual who takes a residential mortgage loan application and offers or negotiates terms of a residential mortgage loan for compensation or gain. The term does not include: (1) any individual who performs purely administrative or clerical tasks on behalf of an individual who is a mortgage loan originator; (2) any individual performing only real estate brokerage activities (as defined in section 1503(3)(D) of the S.A.F.E. Act)[17] and is licensed or registered as a real estate broker in accordance with applicable State law, unless the individual is compensated by a lender, a mortgage broker, or other loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator; or (3) any individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).[18] For purposes of this definition, the proposal defines "administrative or clerical tasks" to mean: (1) the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan; and (2) communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan. The Agencies note that the appendix to the proposal includes examples of the types of activities the Agencies consider to be both within and outside the scope of residential mortgage loan origination activities.

To the extent it is within the scope of the S.A.F.E. Act, the Agencies are requesting comment on whether the definition of "mortgage loan originator" should cover individuals who modify existing residential mortgage loans. If so, the Agencies seek comment on whether these individuals should be excluded from the definition. For example, the Agencies are considering whether the final rule should exclude from this definition persons who modify an existing residential mortgage loan, pursuant to applicable law, provided this modification does not constitute a refinancing (that is, the satisfaction or extinguishment of the original obligation and replacement by a new obligation) and is completed in accordance with a contract between the parties, including any workout agreement.

The Agencies seek comment on whether an exclusion for individuals who modify existing residential mortgage loans would be appropriate in light of the S.A.F.E. Act's objectives of providing increased accountability and tracking of the mortgage loan originators, enhancing consumer protection, reducing fraud in the residential mortgage loan origination process, and providing consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators. Comment is also requested on whether the final rule should delay the registration requirement for individuals engaged in loan modifications for only a specified period in light of current economic conditions and the national importance of encouraging mortgage lenders to engage in foreclosure mitigation activities.

Moreover, the Agencies solicit comment on whether individuals who engage in approving mortgage loan assumptions should be excluded from the proposed definition of "mortgage loan originator" and whether such approach is consistent with the S.A.F.E. Act's objectives.

In particular, commenters are encouraged to: (1) describe the extent to which loan modification and assumption activities are staffed and managed separately from loan origination activities within the institution; (2) provide the number of employees who engage in loan modifications or assumptions and do not otherwise act as mortgage loan originators; (3) describe the types of contact that staff engaged only in modifications or assumptions has with customers and the extent to which such staff initiate contact with customers; (4) discuss whether loan modification staff ever process loan refinancings; and (5) discuss the extent of the information that is gathered from customers in the context of the loan modifications and assumptions. With respect to loan modifications, describe what staff would handle the transaction if the modification process becomes a refinancing of a loan or if a new borrower is added in addition to the original borrower (i.e., adding a cosigner).

With respect to assumptions, describe: (1) whether the loan transactions offered by your institution are typically assumable; (2) the types of assumptions that are permitted, if any; (3) the type of contact between the employee and the new borrower; and (4) differences, if any, between underwriting practices for a loan assumption transaction and a new loan origination. Comment is also specifically requested on whether the exclusion of personnel solely engaged in loan modifications and loan assumptions affects a consumer's ability to assess the competency and credentials of these personnel, keeping in mind the consumer protection and fraud prevention purposes of the S.A.F.E. Act.

To the extent it is within the scope of the S.A.F.E. Act, the Agencies also seek comment on whether individuals who engage in certain refinancing transactions should be excluded from the definition of mortgage loan originator (and, correspondingly whether certain types of refinancing transactions should be excluded from the definition of residential mortgage loan). Specifically, should an individual who engages in refinancings that do not involve a cash-out and are with the same lender be excluded from the definition of mortgage loan originator? With respect to these specific types of refinancing transactions, the Agencies request comment on: (1) whether such transactions have similar results for borrowers as loan modifications; (2) whether employees engaged in such refinancing transactions also engage in other mortgage loan origination activities; (3) the types of contact that employees who engage in these types of refinancings have with customers; (4) the extent to which such staff initiate contact with customers; and (5) the extent of the information that is gathered from customers in the context of these types of refinancing transactions.

Furthermore, the Agencies seek comment on whether individuals who engage in loan modification and limited refinancing activities should be excluded from the definition of mortgage loan originator only if the transactions meet additional criteria. For example, should an individual who engages only in loan modification activities be excluded from the definition of mortgage loan originator only if the modification meets specific criteria such as a lower interest rate, reduced payment, elimination of an impending adjustment to the rate, or reduction in principal? Comment is requested on criteria that should be considered by the Agencies, if any.

Nationwide Mortgage Licensing System and Registry or Registry. The proposal's definition of these terms is based on the definition included in the S.A.F.E. Act. Specifically, these terms mean the system developed and maintained by the CSBS and the AARMR for the State licensing and registration of State-licensed mortgage loan originators and the registration of mortgage loan originators pursuant to section 1507 of the S.A.F.E. Act. The Registry currently supports the licensing and registration of State mortgage loan originators. As explained above, the Agencies are working with the CSBS to modify the Registry to support the registration of mortgage loan originators employed by Agency-regulated institutions.

Registered mortgage loan originator. Pursuant to section 1503(7) of the S.A.F.E. Act, the proposal defines this term to mean any individual who meets the definition of mortgage loan originator and is an employee of an Agency-regulated institution and is registered pursuant to the requirements of this rule with, and maintains a unique identifier through, the Registry. This definition is the same as that included in the S.A.F.E. Act, except that the Agencies have modified it to apply only to individuals registered pursuant to regulations issued by the Agencies.

Residential mortgage loan. As in the S.A.F.E. Act, the proposal defines "residential mortgage loan" as any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act (TILA)[19] or residential real estate upon which is constructed or intended to be constructed a dwelling. In addition, the proposal specifically includes in this definition refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans secured by a dwelling in order to clarify that originators of these types of loans are covered by the rule's requirements.

The FCA emphasizes that section 1503(8) of the S.A.F.E. Act and ___.102(f) do not amend or supersede sections 1.11(b) and 2.4(b) of the Farm Credit Act of 1971, as amended, 12 U.S.C. 2019(b) and 2075(b), and their implementing regulation, 12 CFR 613.3030(c), which establish the purposes for which FCS institutions may originate residential mortgage loans for eligible rural home borrowers.

Unique Identifier. The proposal's definition of this term is identical to that included in section 1503(12) of the S.A.F.E. Act. Specifically, the proposal defines "unique identifier" to mean a number or other identifier that: (1) permanently identifies a registered mortgage loan originator; (2) is assigned by protocols established by the Registry and the Agencies to facilitate electronic tracking of mortgage loan originators, and uniform identification of, and public access to, the employment history of, and the publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators; and (3) must not be used for purposes other than those set forth in the S.A.F.E. Act.

In section ___.103(d), the proposal uses the terms "control" and "financial services-related" in the descriptions of the information that is required of an employee who is a mortgage loan originator. These terms are currently defined in the web-based form collecting information on State-licensed mortgage loan originators. In order to promote consistency of the information collected for Agency-regulated and State-licensed mortgage loan originators, the Agencies intend that the Registry's definitions of those terms will also be used in the web-based form collecting information on Agency-regulated mortgage loan originators and, therefore have not defined them in this rulemaking.[20]

Section ___.103 – Registration of mortgage loan originators

The S.A.F.E. Act specifically prohibits an individual who is an employee of an Agency-regulated institution from engaging in the business of a loan originator without registering as a loan originator with the Registry, maintaining annually such registration, and obtaining a unique identifier through the Registry.[21] As described more specifically below, under § ___.103 of the proposal, both the individual employee and the employing institution are responsible for complying with these requirements. In addition, the proposal requires that both the employee and the employing institution must submit information to the Registry for each registration to be complete.

Employee registration requirement. In general, proposed § ___.103(a)(1) requires employees of Agency-regulated institutions who act as a mortgage loan originator to register with the Registry, maintain their registration, and obtain a unique identifier. The Agencies note that this requirement would not apply if the employee is subject to a de minimis exception. This section further provides that any employee who is not in compliance with the registration and unique identifier requirements set forth in this subpart, by the expiration of the implementation periods specified in § ____.103(a)(3) and (a)(4)(ii), as applicable, is in violation of the S.A.F.E. Act and this rule. The OCC, Board, FDIC, and OTS have the authority to take enforcement actions against their respective Agency-regulated institutions and individual employees of those institutions who violate the S.A.F.E. Act and the final rule, pursuant to 12 U.S.C. 1818. The FCA has authority to take enforcement actions against Farm Credit System institutions and individual employees who violate the S.A.F.E. Act and the final rule pursuant to title V, Part C of the Farm Credit Act of 1971, as amended, 12 U.S.C. 2261 et seq. The NCUA has the authority to take enforcement actions against federally-insured credit unions and their employees who violate the S.A.F.E. Act and the final rule under 12 U.S.C. 1786.

Institution requirement. Unless the de minimis exception applies, paragraph (a)(2) of §

_____.103 provides that an Agency-regulated institution must require its employees who are mortgage loan originators to register with the Registry, maintain this registration, and obtain a unique identifier in compliance with this subpart. This provision also prohibits an Agency-regulated institution from permitting its employees to act as mortgage loan originators unless registered with the Registry pursuant to this subpart, after the implementation periods specified in §§ ____.103(a)(3) and (a)(4)(ii), as applicable, expire.

Implementation period for initial registrations. The proposal provides a grace period for initial registrations. Pursuant to paragraph (a)(3) of this section, an employee is not required to register, and therefore can continue to originate residential mortgage loans without complying with the rule's registration requirement, for 180 days from the date the Agencies provide public notice that the Registry is accepting initial registrations. After this 180-day period expires, any existing employee or newly hired employee of an Agency-regulated institution who is subject to the registration requirements is prohibited from originating residential mortgage loans without first meeting the registration requirements. The Registry, in consultation with the Agencies, is considering a staggered registration process for some of the larger Agency-regulated institutions in order to spread out the registration of mortgage loan originators throughout this implementation period. This could reduce the number of originators registering at any one time, thereby enabling the Registry to accommodate all registrations in a timely and efficient manner.

The Agencies seek comment on whether the 180-day implementation period will provide Agency-regulated institutions and their employees with adequate time to complete the initial registration process. The Agencies also inquire as to whether an alternative schedule for implementation and initial registrations would be appropriate, what such an alternative schedule should be, and why it is more appropriate than the implementation period proposed by the Agencies. In addition, the Agencies request comment on whether, and how, a staggered registration process should be developed.

The Agencies recognize that Agency-regulated institutions and mortgage loan originators need certainty as to when the Registry is available to start accepting registrations and the date that the 180-day clock starts to run. Therefore, the Agencies will provide a coordinated and simultaneous advance notice to Agency-regulated institutions of when the Registry will begin accepting Federal registrations through appropriate means, such as a Federal Register publication, Web-site notice, or agency bulletin.

Special rule for previously registered employees. Under paragraph (a)(4) of § ___.103, properly registered or licensed mortgage loan originators will not have to re-register when they change employment by moving from one Agency-regulated institution to another or from a State-regulated institution to an Agency-regulated institution, regardless of whether the change in employment is made voluntarily, through an acquisition or merger of the employee's prior employer, or through a reorganization where previously State-licensed mortgage loan originators become subject to the registration requirements of Agency-regulated institutions. Specifically, this provision provides that if a new employee of an Agency-regulated institution had previously registered with, and obtained a unique identifier from, the Registry prior to becoming an employee of that institution and has maintained that registration (or license, if previously employed by a State-regulated entity), the registration requirements of this subpart are deemed to be met provided that: (1) the employee's employment information in the Registry is updated; (2) new fingerprints of the employee are provided to the Registry for a new background check, except in the case of mergers, acquisitions or reorganizations; (3) information concerning the new employing institution is provided to the Registry pursuant to § ___.103(e)(1)(i), to the extent the institution has not previously met these requirements, and (e)(2)(i)[22]; and (4) the registration is maintained pursuant to the requirements of paragraph (b) of this section as of the date that the employee is employed by the institution.

In order to reduce regulatory burden and to prevent an interruption in mortgage origination activity, this provision provides a 60-day grace period to comply with these requirements when a registered mortgage loan originator becomes an employee of an Agency-regulated institution as a result of an acquisition, merger, or reorganization. The Agencies seek comment on whether this grace period is appropriate.

Continuing a mortgage loan originator's registration from one employer to another will reduce regulatory burden on Agency-regulated institutions as well as the residential mortgage industry. In addition, because an employee's unique identifier and background information in the Registry will remain the same, consumers will be able to locate a mortgage loan originator who has changed employers. The Agencies note that the registration of a mortgage loan originator who leaves any employer will be inactive until he or she is hired by a new institution, his or her record is updated in accordance with the final rule's requirements, and the new employer acknowledges employing the mortgage loan originator through the Registry. The individual will be prohibited from acting as a mortgage loan originator at an Agency-regulated institution until such time as the registration is reactivated, unless covered by the 60-day grace period.

Maintaining Registration. Under § ___.103(b), a registered mortgage loan originator must renew his or her registration with the Registry during the annual renewal period (November 1 – December 31). To renew, the employee must confirm that the information previously submitted to the Registry remains accurate and complete, updating any information as needed. Any registration that is not renewed during this period will become inactive and the individual will be prohibited from acting as a mortgage loan originator at an Agency-regulated institution until such time as the registration requirements are met. All employee data that has been provided to the Registry about the employee will remain in the Registry even when the employee is in inactive status. Inactive mortgage loan originators will not be assigned a new unique identifier if they reregister.

In addition to the annual renewal, a registration must be updated within 30 days of the occurrence of any of the following events: (1) a change in the employee's name, (2) the registrant ceases to be an employee of the institution; or (3) any of the employee's responses to the information required for registration pursuant to paragraphs (d)(1)(iii) through (xi) become inaccurate. These annual renewal and updating requirements are similar to what is required currently for State-licensed mortgage loan originators.

This paragraph also provides that any employee who registers with the Registry must maintain his or her registration unless the employee is no longer a mortgage loan originator. As a result of this provision, once an employee registers as a loan originator with the Registry, the employee will be required to continue this registration until he or she is no longer engaged in the activity of a mortgage loan originator, even if, in any particular year, the employee originates fewer mortgage loans than the number specified in the de minimis exception provision. The purpose of this requirement is to avoid the creation of a timing loophole that could allow mortgage loan originators to avoid registration requirements.

The Agencies specifically request comment on whether the proposed initial registration requirements as well as the requirements for maintaining registration are adequate and feasible for Agency-regulated institutions and their employees who are mortgage loan originators, yet serve the consumer protection purposes enumerated in the S.A.F.E. Act.

Effective date of registrations and renewals. Paragraph (c) of this section provides that an initial registration is effective on the date that the registrant receives notification from the Registry that all employee and institution information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

A renewal or update pursuant to paragraph (b) is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) of this section has been submitted and the renewal or update is complete.

Except as provided by the 180-day implementation period in § ___.103(a)(3) or the 60-day grace period provided in § ___.103(a)(4), an employee must not engage in mortgage origination if his or her registration is not yet effective or has not been renewed pursuant to this rule.

Required employee information. Paragraph (d) of § ___.103 lists the categories of information that mortgage loan originators, or the employing Agency-regulated institution on behalf of the mortgage loan originator, will be required to submit to the Registry. The Registry's registration form will more specifically identify the information required.

Specifically, the proposal requires the employee to submit information regarding his or her identity (name and former names, social security number, gender, date of birth, and place of birth) and home and business contact information; date the employee became an employee of the Agency-regulated institution; financial services-related employment and financial history for the past 10 years; criminal history involving felonies and certain misdemeanors; history of financial services-related civil actions, arbitrations and regulatory and disciplinary actions or orders; financial services-related professional license revocations or suspensions; voluntary or involuntary employment terminations based on violations of law or industry standards of conduct; and certain actions listed above that are pending against the employee. As explained below, the Agency-regulated institution must have policies and procedures in place for confirming the adequacy and accuracy of employee registrations.

The employee also must provide fingerprints, in digital form if practicable, and any appropriate identifying information to the Registry for submission to the FBI and any other Federal or State governmental agency or entity authorized to do a criminal history background check.[23] The Agencies expect that the Registry will submit fingerprints to the FBI for a criminal history background check in connection with the registration of each mortgage loan originator of an Agency-regulated institution. The Agencies, however, are not requiring employees to obtain new fingerprints for submission to the Registry if the employing Agency-regulated institution has the employee's fingerprints on file, provided that the fingerprints submitted to the Registry were taken less than three years prior to the employee's registration with the Registry. If the Agency-regulated institution has such fingerprints on file, the Registry plans to use these fingerprints to run the required criminal history background check on the mortgage loan originator.

It is the Agencies' understanding that the Registry plans to support digital fingerprinting by October 2009 and likely before the initiation of the proposed rule's implementation period. As digital fingerprints are preferable to paper fingerprints, the proposed rule provides that registrants should submit digital fingerprints to the Registry, if practicable. If digital fingerprints are not available, the Registry will accept fingerprint cards, and will convert these cards to a digital format. The Agencies encourage the use of digital fingerprints and note that the proposal's permission to submit fingerprints in paper form is intended to enable smaller institutions without the capability or feasibility to obtain digital fingerprints to comply with this requirement.

The Agencies specifically seek comment on whether the three-year age limit for existing fingerprints is appropriate and whether Agency-regulated institutions currently have fingerprints of their employees on file, and if so, whether they are in digital or paper form.

Employee authorization and attestation. Paragraph (d)(2) of § ___.103 requires the employee, not the employing Agency-regulated institution, to attest to the correctness of all such information submitted to the Registry pursuant to paragraph (d)(1), and to provide authorization for the Registry and the employing Agency-regulated institution to obtain information related to any administrative, civil or criminal findings to which the employee is a party.

In order to provide relevant information to consumers and to implement the purposes of the S.A.F.E. Act, paragraph (d)(2) requires the employee, not the employing Agency-regulated institution, to authorize the Registry to make available to the public the following information submitted to the Registry: his or her name; other names used; name of current employer(s); current principal business location(s) and business contact information; 10 years of relevant employment history; and publicly adjudicated or pending disciplinary and enforcement actions and arbitrations against the employee. The Agencies envision that this information will be made public in two phases. The first phase, implemented at the time the Registry begins accepting Federal registrations, would provide for public accessibility of the employee's name; other names used; name of current employer(s); current principal business location(s) and business contact information; and employment history. The remaining categories of information (publicly adjudicated or pending disciplinary and enforcement actions and arbitrations against the employee) would be made public at a later date, once the Registry, in consultation with the Agencies, has designed and implemented a system through which the registrant may provide additional explanatory information to accompany a positive response to any of the disclosure questions regarding criminal history or the other information requested in paragraphs (d)(1)(iii) through (xi). The Agencies note that once the Registry makes this enhancement, registered mortgage loan originators can provide this explanatory language at any time or during the annual renewal process, and that this explanatory language may be made public. Additionally, relevant nonpublic information submitted to the Registry will be accessible to the Agencies and State mortgage regulators, as appropriate.

The institution may provide the employee information required under § __.103(d)(1) to the Registry or require the employee to provide the information to the Registry. Regardless of the manner that the information is provided, the requirements of the rule remain the same: the employee must attest to the correctness of the information required by § __.103(d) and the institution must implement policies and procedures to confirm the adequacy and accuracy of employee registrations, including updates and renewals.

The Agencies have limited the required information to what is necessary to meet the objectives of the SA.F.E. Act for the registration of residential mortgage loan originators employed by Agency-regulated institutions and to what is required by the Registry's current data collection form for State mortgage loan originators, Form MU4. The Agencies believe that both the State-licensing and Agency-registration requirements should collect similar information from mortgage loan originators in order to effectively track loan originators, reduce regulatory burden on mortgage loan originators who move between institutions with differing charters and regulators, and permit consumers to review similar information on mortgage loan originators regardless of the originator's regulator. The Agencies and CSBS have worked together to identify what information should be required for registration and will continue to do so going forward.

The Agencies seek comment on the employee data that is proposed to be collected, the employee data that is proposed to be made public, and whether any other additional data should be collected or made public.

Required Agency-regulated institution information. Paragraph (e)(1) of § ___.103 requires the employing Agency-regulated institution to submit certain information to the Registry as a base record in connection with the initial registration of one or more mortgage loan originators. Specifically, the Agency-regulated institution must provide its name, main office address, primary Federal regulator, Employer Identification Number (EIN) issued by the Internal Revenue Service, primary point of contact information, and contact information for "system administrators." If the Agency-regulated institution is a subsidiary, it also must indicate that it is a subsidiary and provide the name of its parent institution, as explained further below.

System administrators will have the authority to enter data required in paragraph (e) of this section on the Registry and will be responsible for keeping institution information and the list of employees registered with the Registry current, provided these individuals do not act as mortgage loan originators. The system administrators may delegate their authority and assign as many additional system users as necessary to comply with the registration requirements of the S.A.F.E. Act and the final rule, provided the delegated administrators meet this paragraph's requirements. The primary point of contact also can be one of the system administrators.

In addition, paragraph (e)(1) requires an Agency-regulated institution to provide its Research Statistics Supervision Discount (RSSD) number. The RSSD database is maintained by the Board. The Agencies expect to provide the Registry with an extract of the Board's database, indexed by RSSD number, to facilitate an Agency-regulated institution's authorized access to the Registry and its establishment of a new base record. Upon receiving the information for a new base record from an Agency-regulated institution, the Registry will confirm the information by comparing the application with data supplied by the Agencies. The Agencies will establish a mechanism by which Agency-regulated institutions that do not have an RSSD number will be added to the RSSD database. However, an operating subsidiary of an Agency-regulated institution will not be required to obtain an RSSD number. Instead, if an operating subsidiary does not have an RSSD number, the operating subsidiary will provide its parent institution's RSSD number and indicate that it is an operating subsidiary of the parent. The Agencies seek comment on the proposal to require Agency-regulated institutions to submit their RSSD number, and operating subsidiaries, if necessary, to submit their parent institution's RSSD number, to facilitate an Agency-regulated institution's authorized access to the Registry and its establishment of a base record, and as identifying data for validating the base record.

Paragraph (e)(1)(ii) of this section requires the Agency-regulated institution to update any information it has submitted within 30 days of the date that the information becomes inaccurate.

Paragraph (e)(2) of this section requires an Agency-regulated institution to provide information to the Registry for each employee who acts as a mortgage loan originator. The Agency-regulated institution must: (1) after all the information required by paragraph (d) of this section has been submitted to the Registry, confirm that it employs the registrant; and (2) within 30 days of the date the registrant ceases to be an employee of the institution, provide notification that it no longer employs the registrant and the date the registrant ceased being an employee. This information will link the registering mortgage loan originator to the Agency-regulated institution in order to confirm that the registration of the employee is valid and legitimate. The Agencies note that the Registry's system protocols will not permit the Agency-regulated institution to confirm that it employs the registrant unless all of the employee's information required by paragraph (d) of this section has been submitted to the Registry.

The Agencies anticipate that some Agency-regulated institutions may select one or more individuals to submit the required employee information on behalf of each of their mortgage loan originators to facilitate this registration process. The Agencies also recognize the initial volume of new registrants could be burdensome on both the registrants and on the staff charged with completing the registrations. To mitigate this burden, the Agencies are considering whether to modify the Registry to permit a "batch" process for Agency-regulated institutions to submit, in bulk, some or all of the required employee and institution data. However, such a process would not eliminate completely an individual employee's role in the registration process or the employee's responsibility to attest to the accuracy of the data submitted on the employee's behalf. Typical automated human resources systems likely will not contain all of the employee information required to be submitted to the Registry under § ___.103(d) of this proposed rule. As a result, the institution would need to gather the missing information from each potential registrant and then format it for the batch processing, which may create some registration burden on administrative staff and lead to possible delays, errors, or omissions. Alternatively, if the Agencies specify a limited set of standard data elements that are likely to be contained in an institution's automated human resources system, such as name and employment date, for the batch file, individual employees would still be required to access the Registry to provide any missing information and complete the registration process. In either case, employees would still be responsible for accessing their record in the Registry to attest to the accuracy of the information submitted on their behalf by the employing institution and authorize background checks and public access to certain employee information.

The Agencies seek comment on batch processing and welcome suggestions for workable alternative approaches that could mitigate the initial registration burden on Agency-regulated institutions and their employees. Comment is also sought on the appropriateness of having one employee input registration information into the Registry on another employee's behalf.

Section ___.104 - Policies and procedures

Proposed § ___.104 requires Agency-regulated institutions that employ mortgage loan originators to adopt and follow written policies and procedures designed to assure compliance with the requirements of the final rule. This requirement applies to all Agency-regulated institutions that employ individuals who act as mortgage loan originators, regardless of the application of any de minimis exception to their employees. This section requires that these policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the Agency-regulated institution and must at a minimum include the following eight provisions.

First, these policies and procedures must establish a process for identifying which employees of the institution are required to be registered mortgage loan originators.

Second, the policies and procedures must require that all employees of the institution who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this rule and be instructed on how to comply with these requirements and procedures, including registering as a mortgage loan originator prior to engaging in any mortgage loan origination activity.

Third, the policies and procedures must establish procedures to comply with the unique identifier requirements in § ___.105.

Fourth, these policies and procedures must establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparison with the institution's records. The Agencies do not expect Agency-regulated institutions, however, to obtain private database searches on their pre-existing employees to confirm employee information. Instead, institutions should compare the information supplied by the employee for purposes of registering with the Registry with the information contained in the institution's own records.

Fifth, these policies and procedures must establish reasonable procedures and tracking systems for monitoring compliance with registration requirements and procedures. Agency-regulated institutions will be expected to be able to demonstrate compliance with the requirements of the S.A.F.E. Act and the final rule, such as by maintaining appropriate records.

Sixth, the policies and procedures must provide for periodic independent testing of the Agency-regulated institution’s policies and procedures for compliance with the S.A.F.E. Act and the final rule, including the registration and renewal requirements, and for such testing to be conducted by institution personnel or by an outside party.

Seventh, the policies and procedures must provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this rule, or the related policies and procedures of the institution, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions.

Eighth, the policies and procedures must establish a process for reviewing the criminal background history reports on employees received from the FBI through the Registry and taking appropriate action consistent with applicable law and rules with respect to these reports. Moreover, an Agency-regulated institution must maintain such records or reports and document any action taken with respect to applicable employees. Institutions should maintain these records consistent with applicable recordkeeping requirements, if any.

The Agencies specifically request comment on the difficulty of establishing suitable policies and procedures including the amount of time and resources needed for their adoption and implementation. The Agencies note that these policies and procedures should be in place at an institution prior to the registration of its employees pursuant to this rule.

Section ___.105 - Use of unique identifier

Section ___.105(a) of the proposal requires an Agency-regulated institution to make the unique identifier(s) of its registered mortgage loan originator(s) available to consumers in a manner and method practicable to the institution. The Agencies note that an Agency-regulated institution may comply with this requirement in a number of ways. For example, the institution may choose to direct consumers to a listing of registered mortgage loan originators and their unique identifiers on its website; post this information prominently in a publicly accessible place, such as a branch office lobby or lending office reception area; or establish a process to ensure that institution personnel provide the unique identifier of a registered mortgage loan originator to consumers who request it from employees other than the mortgage loan originator.[24]

Section ___.105(b) requires a registered mortgage loan originator to provide the originator’s unique identifier to a consumer upon request, before acting as a mortgage loan originator, and through the originator’s initial written communication with a consumer, if any. The Agencies intend § ___.105(b)(3) of the rule to cover written communication from the originator specifically for his or her customers and not written materials distributed by the Agency-regulated institution for general use by its customers.

Although a mortgage loan originator may change his or her name, change employment, or move, the unique identifier assigned to the originator by the Registry at the originator’s initial registration will remain the same. Once public access to the Registry is fully functional, the unique identifier will enable consumer access to an individual mortgage loan originator's profile stored in the Registry, including the mortgage loan originator's registration information, any State licenses held (active or inactive), employment history and other information of interest to the consumer. If a mortgage loan originator is simultaneously employed by more than one State or Agency-regulated institution, that information also will be readily visible to the consumer. Therefore, as this unique identifier will enable a consumer to obtain important information concerning a mortgage loan originator from the Registry, a mortgage loan originator and the employing institution must ensure that the consumer has access to it.

The Agencies seek comment regarding the adequacy and appropriateness of these unique identifier requirements with respect to the consumer protection and anti-fraud purposes of the S.A.F.E. Act. The Agencies also seek comment on whether the proposed rule adequately ensures that consumers will be made aware that they have the opportunity to access information about the employment history of, and publicly adjudicated disciplinary and enforcement actions against, a prospective, current, or former mortgage loan originator. Furthermore, the Agencies seek comment on the specific difficulties that an institution or its employees may have in complying with these requirements and whether there may be circumstances when a registered mortgage loan originator would not be able to provide the unique identifier to a consumer before acting as a mortgage loan originator.

Appendix - Examples of Mortgage Loan Originators

As an aid in the understanding, and to provide examples of the definition of mortgage loan originator, the proposed rule includes an Appendix that provides examples of the type of activities that would cause an employee to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive; they illustrate only the issue described and do not illustrate any other issues that may arise in this proposal. The Agencies request comment on whether the examples are helpful, and if other examples should be added to this Appendix or provided to the public by other means.

The Agencies also request comment on whether there are mortgage loans for which there may be no mortgage loan originator. Are there situations where a consumer applies for and is offered a loan through an automated process (such as a prescreened offer extended to a consumer as part of a mass mailing or an automated loan approval in response to an online application) without contact with a mortgage loan originator? To the extent there are such situations, please describe the contact and communication that a consumer would have with the institution and its employees. The Agencies also seek comment on: (1) the activities conducted by employees with respect to mortgage loan pre-approval; and (2) the typical duties of fulfillment staff that do not involve mortgage loan origination activities.

IV. REQUEST FOR COMMENTS

The Agencies encourage comment on any aspect of this proposal and especially on those issues specifically noted in this preamble.

Agency-regulated institutions are encouraged to identify how many of their employees would qualify as residential mortgage loan originators under this definition, and therefore, would be required to register under this proposed rule. Please provide specific information on the number of employees engaged in mortgage loan origination, with both actual count and as a percentage of total employees, and the number of full-time equivalents (FTEs) engaged in this activity as reported on an institution's Consolidated Reports of Condition and Income (Call reports) or Thrift Financial Reports, as applicable. It would also be very helpful for Agency-regulated institutions to identify the internal departments to which these employees are assigned, and whether they are engaged in activities other than residential mortgage loan origination. Specifically, please discuss the estimated numbers of employees who act as mortgage loan originators who work in the mortgage loan function and those that work in divisions outside of the mortgage loan origination function. Please also describe any activities related to mortgage loan origination in which the staff outside the mortgage loan function engages. Please describe whether fulfillment staff or other employees who are not loan officers act as mortgage loan originators, and the estimated numbers of such employees that the institution would need to register under the proposed rule. This information will enable the Agencies to estimate the number of employees who will seek registration for purposes of evaluating system administration needs and determining if the proposed 180-day implementation period is adequate to allow for initial registration. This information will also assist the Agencies in preparing final analyses of the impact of these registrations under the Regulatory Flexibility Act, Paperwork Reduction Act, Executive Order 12866, and the Unfunded Mandates Reform Act of 1995, as applicable.

Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Pub. L. 106-102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Agencies invite your comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?

- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?

- Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?

- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?

- What else could we do to make the regulation easier to understand?

REGULATORY ANALYSIS:

A. Regulatory Flexibility Act

OCC: Pursuant to § 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under § 604 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and a short, explanatory statement in the Federal Register along with its rule.

We have estimated that this proposal will not have a significant economic impact on a substantial number of small entities. Specifically, we estimate that 653 small national banks are likely to be impacted by the NPRM, with an average total compliance cost per bank estimated at $18,800. We base this analysis using the impact of the proposed rule on compliance costs as a percent of labor costs, as well as compliance costs as a percent of noninterest expenses. Therefore, pursuant to § 605(b) of the RFA, the OCC hereby certifies that this proposal will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not needed.

Board: Pursuant to § 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under § 603 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and a short, explanatory statement in the Federal Register along with its rule.

The proposed rule applies to all banks that are members of the Federal Reserve System (other than national banks) and certain of their respective subsidiaries, branches and Agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), and commercial lending companies owned or controlled by foreign banks. Under regulations issued by the Small Business Administration,[25] a small entity includes banking organizations with assets of $175 million or less (a small banking organization). As of December 31, 2008, there were approximately 501 of the institutions listed above that are small banking organizations. The Board believes that there is no significant economic impact. Compliance costs are estimated to be less than 4% of profits for state member banks. For the other small banking organizations, the Board believes these entities would fall below the de miminis exceptions in Section ____.101(c)(2) of the proposed rule since originating residential mortgages is not part of their primary business. The agencies proposed the de minimis exception in an effort to reduce compliance costs on small businesses. Therefore, pursuant to § 605(b) of the RFA, the Board hereby certifies that this proposal will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not needed.

FDIC: In accordance with the Regulatory Flexibility Act, 5 U.S.C. 601-612 (RFA), an agency must publish an initial regulatory flexibility analysis with its proposed rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banks with less than $175 million in assets). The FDIC hereby certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities.

Approximately 3,274 FDIC-supervised banks are small entities. However, the proposed rule would not apply to approximately 2,430 of those small entities because they originate 25 or fewer residential mortgage loans annually and therefore would qualify for the de minimis exception. Only approximately 844 small entities supervised by the FDIC – about 26% of FDIC-supervised small entities – would be subject to the requirements of the proposed rule. For those 844 small entities, the estimated initial costs for complying with the proposed rule would represent, on average, approximately 0.7% of total non-interest expenses, and the annual compliance costs would represent, on average, approximately 0.3% of total non-interest expenses.

OTS: Pursuant to § 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b) (RFA), the regulatory flexibility analysis otherwise required under § 604 of the RFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and publishes its certification and a short, explanatory statement in the Federal Register along with its rule.

We have estimated that this proposal will not have a significant economic impact on a substantial number of small entities. Specifically, we estimate that 385 small savings associations are likely to be impacted by the NPRM, with an average total compliance cost per savings association estimated at $13,311. Therefore, pursuant to § 605(b) of the RFA, the OTS hereby certifies that this proposal will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not needed.

FCA: Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

NCUA: In accordance with the Regulatory Flexibility Act, 5 U.S.C. 601-612 (RFA), an agency must publish an initial regulatory flexibility analysis with its proposed rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include federally insured credit union with less than $10 million in assets). NCUA hereby certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities.

Approximately 3,231 federally insured credit unions are small entities. However, the proposed rule would not apply to approximately 3,190 of those small entities because they originate 25 or fewer residential mortgage loans annually and therefore would qualify for the de minimis exception. Only approximately 41 small federally insured credit unions, about 1.3% of small entities, would be subject to the requirements of the proposed rule.

B. Paperwork Reduction Act

Request for Comment on Proposed Information Collection

In accordance with section 3512 of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501-3521 (“PRA”), the Federal banking agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (“OMB”) control number. The information collection requirements contained in this joint notice of proposed rulemaking have been submitted by the OCC, FDIC, OTS, and NCUA to OMB for review and approval under section 3506 of the PRA and §1320.11 of OMB’s implementing regulations (5 CFR Part 1320). The FCA collects information from Farm Credit System institutions, which are Federal instrumentalities, in the FCA’s capacity as their safety and soundness regulator, and, therefore, OMB approval is not required for this collection. The Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. The proposed rule contains requirements subject to the PRA. The requirements are found in 12 CFR §§__.103(a)-(b), (d)-(e), __.104, and __.105.

Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Federal banking agencies’ functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

NCUA: Request for comments related to the number of respondents who are mortgage loan originators – Some federally insured credit unions use a credit committee comprised of unpaid volunteers to make lending decisions, including decisions on mortgage loans to members. NCUA requests comments on whether these credit committee members who work for a credit union in an unpaid capacity and approve mortgage loans must register. In addition, NCUA requests comments on whether only some of these credit committee members must register, and if so, which ones and why.

All comments will become a matter of public record. Comments should be addressed to:

OCC: Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mailstop 1-5, Attention: 1557- AD23, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to (202) 874-5274, or by electronic mail to regs.comments@occ.treas.gov. You can inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

Board: You may submit comments, identified by Docket No. R-1357, by any of the following methods:

• Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments on the http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

• FAX: 202-452-3819 or 202-452-3102.

• Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.
All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit written comments, identified by the RIN, by any of the following methods:

• Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow the instructions for submitting comments on the FDIC Web site.

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

• E-mail: Comments@FDIC.gov. Include RIN 3064-AD43 on the subject line of the message.

• Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, FDIC, 550 17th Street, NW., Washington, DC 20429.

• Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Instructions: All comments received will be posted generally without change to http://www.fdic.gov/regulations/laws/federal/propose/html including any personal information provided.

OTS: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552; send a facsimile transmission to (202) 906-6518; or send an e-mail to infocollection.comments@ots.treas.gov. OTS will post comments and the related index on the OTS Internet site at http://www.ots.treas.gov. In addition, interested persons may inspect the comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755.

NCUA: You may submit comments by any of the following methods (Please send comments by one method only):

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

NCUA Web Site: http://www.ncua.gov/RegulationsOpinionsLaws/proposedregs/proposedregs.html. Follow the instructions for submitting comments.

• E-mail**:** Address to regcomments@ncua.gov. Include "[Your name] Comments on Notice of Proposed Rulemaking Part 761 Registration of Mortgage Loan Originators" in the e-mail subject line.

• Fax: (703) 518-6319. Use the subject line described above for e-mail.

• Mail**:** Address to Jeryl Fish, Deputy Chief Information Officer, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

• Hand Delivery/Courier: Same as mail address.

Additionally, you should send a copy of your comments to the OMB Desk Officer for the Federal banking agencies, by mail to U.S. Office of Management and Budget, 725 17th Street, NW., 10235, Washington, DC 20503, or by fax to (202) 395-6974.

Proposed Information Collection

Title of Information Collection: Registration of Mortgage Loan Originators

Frequency of Response: On occasion; Annual.

Affected Public:

OCC: National banks, Federal branches and agencies of foreign banks, their operating subsidiaries, and employees who are loan originators.

Board: Member banks of the Federal Reserve System (other than national banks), their respective subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act; and branches and agencies of foreign banks (other than Federal branches, Federal agencies and insured State branches of foreign banks) and commercial lending companies owned or controlled by foreign banks and their employees who act as mortgage loan originators.

FDIC: State nonmember banks (including State-licensed insured branches of foreign banks) and their subsidiaries (except brokers, dealers, persons providing insurance, investment companies, and investment advisers) and their employees who are mortgage loan originators.

OTS: Savings associations and their operating subsidiaries, and their employees who are mortgage loan originators.

NCUA: Federally chartered credit unions and their employees who are mortgage loan originators.

Abstract:

Unless the de minimis exception or a different implementation period applies, §__.103(a) would require an employee of a depository institution who engages in the business of a mortgage loan originator (MLO) to register with the Registry, maintain such registration, and obtain an unique identifier. Under §__.103(b), a depository institution would require each such registration to be renewed annually and updated within 30 days of the occurrence of specified events. Section __.103(d) describes the categories of information that an employee, or the employing depository institution on the employee's behalf, must submit to the Registry, with the employee's attestation as to the correctness of the information supplied, and his/her authorization to obtain further information. Section __ .103(e) specifies institution and employee information that a depository institution would submit to the Registry in connection with the initial registration of one or more MLOs, and thereafter to update. Section __.104 would require that an agency-regulated institution employing MLOs adopt and follow written policies and procedures, at a minimum addressing certain specified areas, but otherwise appropriate to the nature, size and complexity of their mortgage lending activities. Section __.105 would require a depository institution to make the unique identifier(s) of its registered MLO(s) available to consumers in a manner and method practicable to the institution. It would also require a registered MLO to provide his or her unique identifier to a consumer upon request, before acting as a MLO, and through the originator's initial written communication with a consumer, if any.

Estimated Burden:

OCC

Number of Bank Respondents: 1,771 (1,464 national banks; 307 operating subsidiaries)

Burden per Bank for Initial Set up: 351 hours (220 hours to implement policies and procedures and establish tracking and compliance systems; 131 hours to establish reporting, filing, and information dissemination systems)

Total Bank Burden for Initial Set up: 621,621

Number of MLO Employees for Initial Set up: 117,772

Burden Per MLO Employee for Initial Set up: 3.50 hours (2.50 hours to provide information to Registry, and 1 hour to provide Unique Identifier to a consumer, upon request and at initial contact)

Total Burden for MLO Employees for Initial Set up: 412,202 hours

Number of MLO Employees for Registration Update: 58,886

Burden Per MLO Employee for Registration Update: 0.25 hours

Total Burden for MLO Employees for Registration Update: 14,721.5 hours

Total OCC Annual Burden: 1,048,544.5 hours

Board

Number of Bank Respondents: 2,382

Burden per Bank for Initial Set up: 351 hours (220 hours to implement policies and procedures and establish tracking and compliance systems; 131 hours to establish reporting, filing, and information dissemination systems)

Total Bank Burden for Initial Set up: 836,082 hours

Number of MLO Employees for Initial Set up: 27,000

Burden per MLO Employee for Initial Set up: 3.50 hours (2.50 hours to provide information to Registry, and 1 hour to provide Unique Identifier to a consumer)

Total Burden for MLO Employees for Initial Set up: 94,500 hours

Number of MLO Employees for Registration Update: 13,500

Burden per MLO Employee for Registration Update: 0.25 hours

Total Burden for MLO Employees for Registration Update: 3,375 hours

Total Board Annual Burden: 933,957 hours

FDIC

Number of Bank Respondents: 5,371

Burden per Bank for Initial Set up: 351 hours (220 hours to implement policies and procedures and establish tracking and compliance systems; 131 hours to establish reporting, filing, and information dissemination systems)

Total Bank Burden for Initial Set up: 1,885,221 hours

Number of MLO Employees for Initial Set up: 49,719

Burden per MLO Employee for Initial Set up: 3.50 hours (2.50 hours to provide information to Registry, and 1 hour to provide Unique Identifier to a consumer, upon request and at initial contact)

Total Burden for MLO Employees for Initial Set up: 174,016.5 hours

Number of MLO Employees for Registration Update: 24,860

Burden per MLO Employee for Registration Update: 0.25 hours

Total Burden for MLO Employees for Registration Update: 6,215 hours

Total FDIC Annual Burden: 2,065,452.5 hours

OTS

Number of Savings Association Respondents: 1,022 (802 savings associations; 220 operating subsidiaries)

Burden per Savings Association for Initial Set up: 351 hours (220 hours to implement policies and procedures and establish tracking and compliance systems; 131 hours to establish reporting, filing, and information dissemination systems)

Total Savings Association Burden for Initial Set up: 358,722

Number of MLO Employees for Initial Set up: 48,958

Burden per MLO Employee for Initial Set up: 3.50 hours (2.50 hours to provide information to Registry, and 1 hour to provide Unique Identifier to a consumer, upon request and at initial contact)

Total Burden for MLO Employees for Initial Set up: 171,353 hours

Number of MLO Employees for Registration Update: 24,479

Burden per MLO Employee for Registration Update: 0.25 hours

Total Burden for MLO Employees for Registration Update: 6,120 hours

Total OTS Annual Burden: 536,195 hours

NCUA

Number of Credit Union Respondents: 2,834 credit unions.

Burden per Credit Union for Initial Set up: 351 hours (220 hours to implement policies and procedures and establish tracking and compliance systems; 131 hours to establish reporting, filing, and information dissemination systems)

Total Credit Union Burden for Initial Set up: 994,734 hours

Number of MLO Employees for Initial Set up: 23,539

Burden per MLO Employee for Initial Set up: 3.50 hours (2.25 hours to provide information to Registry, and 1 hour to provide Unique Identifier to a consumer, upon request and at initial contact)

Total Burden for MLO Employees for Initial Set up: 82,386.5 hours

Number of MLO Employees for Registration Update: 11,770

Burden per MLO Employee for Registration Update: 0.25 hours

Total Burden for MLO Employees for Registration Update: 2,942.50 hours

Total NCUA Annual Burden: 1,080,063 hours

C. OCC AND OTS Executive Order 12866 Determination

The OCC and the OTS have determined that this proposal is not a significant regulatory action under Executive Order 12866. We have concluded that the changes made by this rule will not have an annual effect on the economy of $100 million or more. The OCC and the OTS further conclude that this proposal does not meet any of the other standards for a significant regulatory action set forth in Executive Order 12866.

D. OCC and OTS Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1532), requires the OCC and OTS to prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. However, this requirement does not apply to regulations that incorporate requirements specifically set forth in law. Because this proposed rule implements the S.A.F.E. Act, the OTS and OCC have not conducted an Unfunded Mandates Analysis for this rulemaking.

E. NCUA Executive Order 13132 Determination

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5) voluntarily complies with the Executive Order. The proposed rule applies to federally insured credit unions and would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The NCUA has determined that the proposed rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

F. NCUA: The Treasury and General Government Appropriations Act, 1999-Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

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[1] The S.A.F.E. Act was enacted as part of the Housing and Economic Recovery Act of 2008, Pub. L. 110-289, Division A, Title V, sections 1501 – 1517, 122 Stat. 2654, 2810 – 2824 (July 30, 2008), codified at 12 U.S.C. 5101- 5116. Citations in this preamble are to the "S.A.F.E. Act" by section number in the public law.

[2] If the Secretary of Housing and Urban Development (HUD) determines that any State fails, within the statutorily prescribed time frame, to establish a licensing regime that meets the requirements of the S.A.F.E. Act, the Secretary is required to establish a system for the licensing and registration of mortgage loan originators in that State. S.A.F.E. Act at section 1508. HUD has reviewed the model legislation developed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to assist States in meeting the minimum requirements of the S.A.F.E. Act and found it to meet these requirements. See 74 FR 312 (Jan. 5, 2009) and http://www.hud.gov/offices/hsg/sfh/mps/smlicact.cfm.

[3] The OCC, Board, FDIC, OTS, and NCUA are referred to both in the S.A.F.E. Act and in this rulemaking

as the "Federal banking agencies."

[4] See S.A.F.E. Act at section 1502.

[5] Id. at section 1507(a).

[6] As of the date of this proposal, 26 States use this system to manage the processing of their mortgage licenses. This system is owned and operated by the State Regulatory Registry LLC (SRR), a limited-liability company established by CSBS as a wholly-owned subsidiary to develop and operate nationwide systems for State regulators in the financial services industry, and has been built and is maintained by the Financial Industry Regulatory Authority (FINRA), which operates similar systems in the securities industry. To obtain more information on this system, see http://www.stateregulatoryregistry.org. (For purposes of this rulemaking, reference to the Registry refers, as applicable, to the system itself and to CSBS and SRR.)

[7] The Agencies note that some employees of Agency-regulated institutions may also be subject to the State licensing and registration regime. For example, employees who act as mortgage loan originators for a bank and a nondepository subsidiary of a bank holding company would be subject to both regimes.

[8] Because each Agency's proposed rule will amend a different part of the Code of Federal Regulations but will have a similar numbering, relevant sections are cited, for example, as "§ ___.101" unless otherwise noted.

[9] Section 3 of the FDI Act defines "depository institution" as any bank or savings association. The term "bank" in section 3 of the FDI Act means any national bank, State bank, Federal branch, and insured branch and includes any former savings association. The term "savings association" means any Federal savings association, state savings association, and any corporation other than a bank that the FDIC and the OTS jointly determine to be operating in substantially the same manner as a savings association. 12 U.S.C. 1813.

[10] The S.A.F.E. Act's definition of depository institution includes Federal branches of foreign banks but not Federal agencies of foreign banks. However, the OCC has applied the Federal registration requirements to these entities because they are Federally regulated and have the authority to originate residential mortgage loans and, therefore, should not be treated differently from other Federally regulated or Federally insured institutions.

[11] The Board notes that it proposes to cover branches and agencies of foreign banks (other than Federal branches, Federal agencies and insured State branches of foreign banks); and commercial lending companies owned or controlled by foreign banks pursuant to its authority under the International Banking Act (IBA) (Chapter 32 of Title 12) to issue such rules it deems necessary in order to perform its respective duties and functions under the chapter and to administer and carry out the provisions and purposes of the chapter and prevent evasions thereof. 12 U.S.C. 3108(a). The Board notes that the IBA provides, in relevant part, that the above entities shall conduct their operations in the United States in full compliance with provisions of any law of the United States which impose requirements that protect the rights of consumers in financial transactions, to the extent that the branch, agency, or commercial lending company engages in activities that are subject to such laws, and apply to State-chartered banks, doing business in the State in which such branch or agency or commercial lending company, as the case may be, is doing business. 12 U.S.C. 3106a(b)(1). Under the Board's proposal the above entities would be subject to the same Federal registration requirements as Federal branches, Federal agencies and insured

State branches of foreign banks, which are covered in the OCC and FDIC rules, respectively.

[12]Some FCS associations may not exercise their statutory authority to make residential mortgage loans, and FCS banks no longer engage in residential mortgage origination activities because they have transferred their direct lending authority to their affiliated associations. The FCA emphasizes that employees of FCS banks and associations that do not engage in residential mortgage loan origination activities are not subject to the registration requirements of the S.A.F.E. and these regulations. The Federal Agricultural Mortgage Corporation (Farmer Mac) is an FCS institution that among other activities operates a secondary market for rural residential mortgage loans. The FCA determines that Farmer Mac employees are not subject to the registration requirements of the S.A.F.E. Act and these implementing regulations because Farmer Mac does not engage in mortgage loan origination activities for rural residents. The Farmer Mac secondary market is modeled after Fannie Mae and Freddie Mac, and the provisions of the S.A.F.E. Act do not expressly apply to employees at Fannie Mae and Freddie Mac.

[13]See S.A.F.E. Act at sections 1507(c) (de minimis exceptions), 1504(a)(1)(A) (requirement to register), 1504(a)(2) (requirement to obtain a unique identifier).

[14]For example, assume an Agency-regulated institution has six employees, A, B, C, D, E, and F who are not registered loan originators for an Agency-regulated institution. Employees A, B, C, and D have acted as mortgage loan originators on five mortgage loans each during the same 12-month period, while employee E has acted as a mortgage loan originator with respect to four mortgage loans during this same time. Employee F has not acted as a mortgage loan originator during this 12-month period. The institution has not exceeded its aggregate exception limit of 25 mortgage loans. Employees A, B, C, and D must register before acting as a mortgage loan originator with respect to any additional mortgage loan during this 12-month period because any one of them would exceed the individual exception limit of five mortgage loans each. Employee E, who has acted as a mortgage loan originator with respect to four loans may act as a mortgage loan originator with respect to one more loan because he or she would not exceed the individual exception limit of five mortgage loans and the institution would not exceed the aggregate exception limit of 25 mortgage loans. After employee E acts as a mortgage loan originator with respect to his or her fifth loan, and the 25th loan for the institution, the exception in ___.101(c) is no longer available to any employee (A, B, C, D, E, or F) who acts as a mortgage loan originator at the institution during this 12-month period.

[15]The FCA joins the Federal banking agencies in proposing a de minimis exception pursuant to its authority under section 5.17(a) (11) of the Farm Credit Act of 1971, as amended, 12 U.S.C. 2252(a)(11) to "exercise such incidental powers as may be necessary or appropriate to fulfill its duties . . ." In this case, the FCA is exercising its incidental powers to fulfill the requirement in the S.A.F.E. Act that it work together the Federal banking agencies to develop and maintain a system for registering residential mortgage loan originators at Agency-regulated institutions with the Registry. A coordinated and uniform approach to the de minimis exception among the Agencies is appropriate because it best fulfills the objectives of the S.A.F.E. Act.

[16]For 2009, that amount is $39 million. See 73 FR 78616 (Dec. 23, 2008). Pursuant to HMDA (12 U.S.C. 2808) and Board Regulation C (12 CFR 203.2(e)(1)(i)), the asset-size threshold is adjusted annually based on year-to-year changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers.

[17]The S.A.F.E. Act defines "real estate brokerage activity" to mean any activity that involves offering or providing real estate brokerage services to the public, including: (i) acting as a real estate agent or real estate broker for a buyer, seller, lessor, or lessee of real property; (ii) bringing together parties interested

in the sale, purchase, lease, rental, or exchange of real property; (iii) negotiating, on behalf of any party, any portion of a contract relating to the sale, purchase, lease, rental, or exchange of real property (other than in connection with providing financing with respect to any such transaction); (iv) engaging in any activity for which a person engaged in the activity is required to be registered or licensed as a real estate agent or real estate broker under any applicable law; and (v) offering to engage in any activity, or act in any capacity, described in clause (i), (ii), (iii), or (iv). S.A.F.E. Act at § 1503(3)(D). Nothing in this proposal would constitute an authorization for Agency-regulated institutions to engage in real estate brokerage, or any other activity, for which the institution does not have independent authority pursuant to Federal or State law, as applicable.

[18] "Timeshare plan" is defined in 11 U.S.C. 101 (53D) as an interest purchased in any arrangement, plan, scheme, or similar device, but not including exchange programs, whether by membership, agreement, tenancy in common, sale, lease, deed, rental agreement, license, right to use agreement, or by any other means, whereby a purchaser, in exchange for consideration, receives a right to use accommodations, facilities, or recreational sites, whether improved or unimproved, for a specific period of time less than a full year during any given year, but not necessarily for consecutive years, and which extends for a period of more than three years. A "timeshare interest" is that interest purchased in a timeshare plan which grants the purchaser the right to use and occupy accommodations, facilities, or recreational sites, whether improved or unimproved, pursuant to a timeshare plan.

[19]TILA defines "dwelling" as a residential structure or mobile home which contains one-to-four family housing units, or individual units of condominiums or cooperatives. 15 U.S.C. 1502(v). Board regulations and commentary include in this definition any residential structure that contains one to four units, whether or not that structure is attached to real property, and includes an individual condominium unit, cooperative unit, mobile home, trailer, and boat if they are in fact used as a residence. See 12 CFR 226.2(a)(19) (Regulation Z).

[20]The Registry currently defines "control" as the power, directly or indirectly, to direct the management or policies of a company or business, whether through ownership of securities, by contract, or otherwise. Any person who is a general partner or executive officer, including Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, Director and individuals with similar status or functions; directly or indirectly has the right to vote 10 percent or more of a class of a voting security or has the power to sell or direct the sale of 10 percent or more of a class of voting securities; or, in the case of a partnership, has the right to receive upon dissolution, or has contributed, 10 percent or more of the capital, is presumed to control that company. The Agencies have requested that this definition be revised to include "Chief Credit Officer." The Registry's current definition of "Financial services-related" means pertaining to securities, commodities, banking, insurance, consumer lending, or real estate (including, but not limited to, acting or being associated with a bank or savings association, credit union, mortgage lender, mortgage broker, real estate salesperson or agent, closing agent, title company, or escrow agent). The Agencies have requested that this definition be revised to include "Farm Credit System institution" and "appraiser."

[21]See S.A.F.E. Act at section 1504(a).

[22]These provisions require: the institution's name, main office address, IRS Employer Tax Identification Number, Research Statistics Supervision Discount (RSSD) number; primary Federal regulator, contact information for individuals at the institution for Registry purposes; and confirmation that it employs the registrant. Information regarding an institution's RSSD number is available from the Board.

[23]Further information on the Registry's fingerprint and background check procedures may be found on the

Registry's website at www.stateregulatoryregistry.org/NMLS/.

[24]The Agencies note that the Federal Housing Finance Agency (FHFA) has directed Fannie Mae and Freddie Mac to require all mortgage loan applications taken on and after January 1, 2010 to include the mortgage loan originator's unique identifier. See FNMA LL 02-2009: New Mortgage Loan Data Requirements (02/13/09).

[25]See 13 CFR § 121.201.

LIST OF SUBJECTS

12 CFR Part 34

Mortgages, National banks, Reporting and recordkeeping requirements.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Consumer protection, Crime, Currency, Insurance, Investments, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 365

Banks, banking, Mortgages.

12 CFR Part 563

Accounting, Administrative practice and procedure, Advertising, Conflict of interests, Crime, Currency, Holding companies, Investments, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

12 CFR Part 610

Banks, banking, Consumer protection, Loan programs – housing and community development, Mortgages, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 761

Credit unions, Mortgages, Reporting and recordkeeping requirements.

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the preamble, chapter I of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 34 – REAL ESTATE LENDING AND APPRAISALS

1. The authority citation for part 34 is revised to read as follows:

Authority: 12 U.S.C. 1 et seq., 29, 93a, 371, 1701j-3, 1828(o), 3331 et seq., and 5101 et seq.

2. Add Subpart F to part 34 to read as follows:

Subpart F—Registration of Residential Mortgage Loan Originators

34.101 Authority, purpose, and scope.
34.102 Definitions.
34.103 Registration of mortgage loan originators.

Subpart F—Registration of Residential Mortgage Loan Originators

§ 34.101 Authority, purpose, and scope.

(a) Authority. This subpart is issued pursuant to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, title V of the Housing and Economic Recovery Act of 2008 (S.A.F.E. Act) (Pub. L. 110-289, 122 Stat. 2654, 12 U.S.C. 5101 et seq.).

(b) Purpose. This subpart implements the S.A.F.E. Act's Federal registration requirement for mortgage loan originators. The S.A.F.E. Act provides that the objectives of this registration include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of mortgage loan originators; enhancing consumer protections; reducing fraud in the residential mortgage loan origination process; and providing consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators.

(c) Scope. (1) In general. This subpart applies to national banks, Federal branches and agencies of foreign banks, their operating subsidiaries (collectively referred to in this subpart as national banks), and their employees who act as mortgage loan originators.

(2) Exception. (i) This subpart and the requirements of sections 1504(a)(1)(A) and (2) of the S.A.F.E. Act do not apply to any employee of a national bank if during the past 12 months:

(A) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and

(B) The national bank employs mortgage loan originators who, while excepted from registration pursuant to paragraph (c)(2)(i)(A) of this section, in the aggregate, acted as a mortgage loan originator in connection with 25 or fewer residential mortgage loans.

(ii) Prior to engaging in mortgage loan origination activity that exceeds either the individual or the aggregate exception limit, a national bank employee must register with the Registry pursuant to this subpart.

§ 34.102 Definitions.

For purposes of this subpart F, the following definitions apply:

(a) Annual renewal period means November 1 through December 31 of each year.

(b)(1) Mortgage loan originator[3] means an individual who:

(i) Takes a residential mortgage loan application; and

(ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain.

(2) The term mortgage loan originator does not include:

(i) An individual who performs purely administrative or clerical tasks on behalf of an individual who is described in paragraph (b)(1) of this section;

(ii) An individual who only performs real estate brokerage activities (as defined in section 1503(3)(D) of the S.A.F.E. Act) and is licensed or registered as a real estate broker in accordance with applicable State law, unless the individual is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator in paragraph (b)(1) of this section; or

(iii) An individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).

(3) Administrative or clerical tasks means the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage

loan.

(c) Nationwide Mortgage Licensing System and Registry or Registry means the system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the State licensing and registration of State-licensed mortgage loan originators and the registration of mortgage loan originators pursuant to section 1507 of the S.A.F.E. Act.

(d) Registered mortgage loan originator or registrant means any individual who:

(1) Meets the definition of mortgage loan originator and is an employee of a national bank; and

(2) Is registered pursuant to this subpart with, and maintains a unique identifier through, the Registry.

(e) Residential mortgage loan means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act, 15 U.S.C. 1602(v)) or residential real estate upon which is constructed or intended to be constructed a dwelling, and includes refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans that meet the qualifications listed in this definition.

(f) Unique identifier means a number or other identifier that:

(1) Permanently identifies a registered mortgage loan originator;

(2) Is assigned by protocols established by the Nationwide Mortgage Licensing System and Registry, the Federal banking agencies, and the Farm Credit Administration to facilitate:

(i) Electronic tracking of mortgage loan originators; and

(ii) Uniform identification of, and public access to, the employment history of and the publicly adjudicated disciplinary and enforcement actions against mortgage loan originators; and

(3) Must not be used for purposes other than those set forth under the S.A.F.E. Act.

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[3] The Appendix to this subpart provides examples of activities that would, and would not, cause an employee to fall within this section's definition of mortgage loan originator.

§ 34.103 Registration of mortgage loan originators.

(a) Registration requirement. (1) Employee registration. Each employee of a national bank who acts as a mortgage loan originator must register with the Registry, obtain a unique identifier, and maintain this registration in accordance with the requirements of this subpart. Any such employee who is not in compliance with the registration and unique identifier requirements set forth in this subpart is in violation of the S.A.F.E. Act and this subpart.

(2) National bank requirement. (i) In general. A national bank that employs one or more individuals who act as a residential mortgage loan originator must require each employee who is a mortgage loan originator to register with the Registry, maintain this registration, and obtain a unique identifier in accordance with the requirements of this subpart.

(ii) Prohibition. A national bank must not permit an employee of the bank who is subject to the registration requirements of this subpart to act as a mortgage loan originator unless such employee is registered with the Registry pursuant to this subpart.

(3) Implementation period for initial registration. An employee of a national bank who is a mortgage loan originator must complete an initial registration with the Registry pursuant to this subpart within 180 days from the date that the OCC provides public notice that the Registry is accepting registrations.

(4) Employees previously registered or licensed through the Registry. (i) In general. If an employee of a national bank was registered or licensed through, and obtained a unique identifier from, the Registry prior to becoming an employee of the bank and has maintained this registration or license, the registration requirements of the S.A.F.E. Act and this subpart are deemed to be met, provided that:

(A) The employment information in paragraphs (d)(1)(i)(C) and (d)(1)(ii) of this section is updated and the requirements of paragraph (d)(2) of this section are met;

(B) New fingerprints of the employee are submitted to the Registry for a background check, as required by paragraph (d)(1)(xii) of this section;

(C) The national bank information required in paragraphs (e)(1)(i) (to the extent the bank has not previously met these requirements) and (e)(2)(i) of this section is submitted to the Registry; and

(D) The registration is maintained pursuant to paragraphs (b) and (e)(1)(ii) of this section, as of the date that the employee is employed by the bank.

(ii) Implementation period for certain acquisitions, mergers or reorganizations. When registered or licensed mortgage loan originators become national bank employees as a result of an acquisition, merger or reorganization transaction, the bank and employees must comply with the requirements of paragraphs (a)(4)(i)(A), (C), and (D) of this section within 60 days from the effective date of the acquisition, merger, or reorganization.

(b) Maintaining registration. (1) A mortgage loan originator who is registered with the Registry pursuant to paragraph (a) of this section must:

(i) Renew the registration during the annual renewal period, confirming the responses set forth in paragraphs (d)(1)(i) through (xi) of this section remain accurate and complete, and updating this information, as appropriate; and

(ii) Update the registration within 30 days of any of the following events:

(A) A change in the name of the registrant;

(B) The registrant ceases to be an employee of the national bank; or

(C) The information required under paragraphs (d)(1)(iii) through (xi) of this section becomes inaccurate, incomplete, or out-of-date.

(2) A registered mortgage loan originator must maintain his or her registration, notwithstanding the originator's subsequent qualification for the exception set forth in § 34.101(c)(2), unless the individual is no longer engaged in the activity of a mortgage loan originator.

(c) Effective dates. (1) Initial registration. An initial registration pursuant to paragraph (a) of this section is effective on the date the registrant receives notification from the Registry that all information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

(2) Renewals or updates. A renewal or update pursuant to paragraph (b) of this section is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) of this section has been submitted and the renewal or update is complete.

(d) Required employee information. (1) In general. For purposes of the registration required by this section, a national bank must require each employee who is a mortgage loan originator to submit to the Registry, or must submit on behalf of the employee, the following categories of information to the extent this information is collected by the Registry:

(i) Identifying information, including the employee's:

(A) Name and any other names used;

(B) Home address;

(C) Address of the employee's principal business location and business contact information;

(D) Social security number;

(E) Gender; and

(F) Date and place of birth;

(ii) Financial services-related employment history for the 10 years prior to the date of registration or renewal, including the date the employee became an employee of the bank;

(iii) Financial information for the 10 years prior to the date of registration or renewal constituting a history of any personal bankruptcy; business bankruptcy based upon events that occurred while the employee exercised control over an organization; denied, paid out, or revoked bonds; or unsatisfied judgments or liens against the employee;

(iv) Felony convictions or other final criminal actions involving a felony against the employee or organizations controlled by the employee; or misdemeanor convictions or other final misdemeanor actions against the employee or organizations controlled by the employee involving financial services, a financial services-related business, dishonesty, or breach of trust;

(v) Civil judicial actions against the employee in connection with financial services-related activities, dismissals with settlements, judicial findings that the employee violated financial services-related statutes or regulations, except for actions dismissed without a settlement agreement;

(vi) Actions or orders by a State or Federal regulatory agency or foreign financial regulatory authority that:

(A) Found the employee to have made a false statement or omission or been dishonest, unfair or unethical; to have been involved in a violation of a financial services-related regulation or statute; or to have been a cause of a financial services-related business having its authorization to do business denied, suspended, revoked or restricted;

(B) Are entered against the employee in connection with a financial services-related activity;

(C) Denied, suspended, or revoked the employee's registration or license to engage in a financial services-related activity; disciplined the employee or otherwise by order prevented the employee from associating with a financial services-related business or restricted the employee's activities; or

(D) Barred the employee from association with an entity regulated by the agency or authority or from engaging in a financial services-related business;

(vii) Final orders issued by a State or Federal regulatory agency or foreign financial regulatory authority based on violations of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct;

(viii) Revocation or suspension of the employee's authorization to act as an attorney, accountant, or State or Federal contractor;

(ix) Customer-initiated financial services-related arbitration or civil action against the employee that required action, including settlements;

(x) Disclosure of any voluntary or involuntary employment terminations resulting from allegations accusing the employee of violating a statute, regulation, or industry standard of conduct; fraud; dishonesty; theft; or the wrongful taking of property;

(xi) Any pending actions against the employee that could result in an action listed in paragraphs (d)(1)(iii) through (ix) of this section; and

(xii) Fingerprints of the employee, in digital form if practicable, collected by the employing institution less than three years prior to registration and any appropriate identifying information for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information in connection with a State and national criminal history background check.

(2) Employee authorization and attestation. An employee registering as a mortgage loan originator or renewing his or her registration under this subpart must:

(i) Authorize the Registry and the employing institution to obtain information related to any administrative, civil or criminal findings, to which the employee is a party, made by any governmental jurisdiction;

(ii) Attest to the correctness of all information required by paragraph (d) of this section, whether submitted by the employee or on behalf of the employee by the employing bank; and

(iii) Authorize the Registry to make available to the public information required by paragraphs (d)(1)(i)(A) and (C), (d)(1)(ii), (iv) – (ix) and (xi) of this section.

(e) Required bank information. A national bank must submit the following information to the Registry.

(1) Bank record. (i) In connection with the initial registration of one or more mortgage loan originators:

(A) Name and main office address;

(B) Internal Revenue Service Employer Tax Identification Number (EIN);

(C) Research Statistics Supervision and Discount (RSSD) number, as issued by the Board of Governors of the Federal Reserve System;

(D) Identification of its primary Federal regulator;

(E) Name(s) and contact information of the individual(s) with authority to act as the bank's primary point of contact for the Registry;

(F) Name(s) and contact information of the individual(s) with authority to enter data required in paragraph (e) of this section on the Registry and who may delegate this authority to other bank employees, provided this individual and any delegated employee does not act as a mortgage loan originator; and

(G) If a subsidiary of a national bank, indication that it is a subsidiary and the name of its parent bank.

(ii) A national bank must update the information required by this paragraph (e) within 30 days of the date that this information becomes inaccurate.

(2) Employee information. In connection with the registration of each employee who acts as a mortgage loan originator:

(i) After the information required by paragraph (d) of this section has been submitted to the Registry, confirmation that it employs the registrant; and

(ii) Within 30 days of the date the registrant ceases to be an employee of the bank, notification that it no longer employs the registrant and the date the registrant ceased being an employee.

§ 34.104 Policies and procedures.

A national bank that employs mortgage loan originators must adopt and follow written policies and procedures designed to assure compliance with this subpart. These policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the bank. At a minimum, these policies and procedures must:

(a) Establish a process for identifying which employees of the bank are required to be registered mortgage loan originators;

(b) Require that all employees of the national bank who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this subpart and be instructed on how to comply with such requirements and procedures;

(c) Establish procedures to comply with the unique identifier requirements in § 34.105;

(d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;

(e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;

(f) Provide for independent testing for compliance with this subpart to be conducted by bank personnel or by an outside party;

(g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this subpart, or the bank's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and

(h) Establish a process for reviewing employee criminal history background reports received from the Registry in connection with § 34.103(d)(1)(xii), taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

§ 34.105 Use of unique identifier.

(a) The national bank shall make the unique identifier(s) of its registered mortgage loan originator(s) available to consumers in a manner and method practicable to the institution.

(b) A registered mortgage loan originator shall provide his or her unique identifier to a consumer:

(1) Upon request;

(2) Before acting as a mortgage loan originator; and

(3) Through the originator's initial written communication with a consumer, if any.

Appendix A to Subpart F of Part 34-Examples of Mortgage Loan Originator Activities

This Appendix provides examples to aid in the understanding of activities that would cause an employee of a national bank to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive. They illustrate only the issue described and do not illustrate any other issues that may arise under this subpart. For the purposes of the examples below, the term "loan" refers to a residential mortgage loan.

(a) Taking a loan application: The following examples illustrate when an employee takes or does not take, a loan application.

(1) Taking an application includes: receiving information that is sufficient to determine whether the consumer qualifies for a loan, even if the employee has had no contact with the consumer and is not responsible for further verification of information.

(2) Taking an application does not include any of the following activities performed solely or in combination:

(i) Contacting a consumer to verify the information in the loan application by obtaining documentation, such as tax returns or payroll receipts;

(ii) Receiving a loan application through the mail and forwarding it, without review, to loan approval personnel; or

(iii) Assisting a consumer who is filling out an application by clarifying what type of information is necessary for the application or otherwise explaining the loan application process in response to consumer inquiries.

(b) Offering or negotiating terms of a loan: The following examples are designed to illustrate when an employee offers or negotiates terms of a loan, and conversely, what does not constitute offering or negotiating terms of a loan.

(1) Offering or negotiating the terms of a loan includes:

(i) Presenting a loan offer to a consumer for acceptance, either verbally or in writing, even if further verification of information is necessary and the offer is conditional; or

(ii) Responding to a consumer's request for a lower rate or lower points on a pending loan application by presenting to the consumer a revised loan offer, either verbally or in writing, that includes a lower interest rate or lower points than the original offer.

(2) Offering or negotiating terms of a loan does not include solely or in combination:

(i) Providing general explanations in response to consumer queries regarding qualification for a specific loan product, such as explaining loan terminology (i.e., debt-to-income ratio) or lending policies (i.e., the loan-to-value ratio policy of the national bank);

(ii) In response to a consumer's request, informing a consumer of the loan rates that are publicly available such as on the national bank's website for specific types of loan products without communicating to the consumer whether qualifications are met for that loan product;

(iii) Collecting information about a consumer in order to provide the consumer with information on loan products for which the consumer generally may qualify, without presenting a specific loan offer to the consumer for acceptance, either verbally or in writing;

(iv) Arranging the loan closing or other aspects of the loan process, including communicating with a consumer about those arrangements, provided that communication with the consumer only verifies loan terms already offered or negotiated; or

(v) Providing a consumer with information unrelated to loan terms, such as the best days of the month for scheduling loan closings at the bank.

(c) The following examples illustrate when an employee does or does not offer or negotiate terms of a loan "for compensation or gain."

(1) Offering or negotiating terms of a loan for compensation or gain includes engaging in any of the activities in paragraph (b)(1) of this Appendix in the course of carrying out employment duties, even if the employee does not receive a referral fee or commission or other special compensation for the loan.

(2) Offering or negotiating terms of a loan for compensation or gain does not include engaging in a seller-financed transaction for the employee's personal property that does not involve the national bank.

Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the preamble, chapter II of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 208 – MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for part 208 is revised to read as follows:

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1816, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p–1, 1831r–1, 1831w, 1831x, 1835a, 1882, 2901–2907, 3105, 3106a(b)(1), 3108(a), 3310, 3331–3351, and 3906–3909, 5101 et seq., 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 780–4(c)(5), 78q, 78q–1, 78w, 1681s, 1681w, 6801 and 6805; 31 U.S.C. 5318, 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. Subpart I , consisting of §§208.100 and 208.101, is redesignated as Subpart J, consisting of §§208.110 and 208.111.

3. New subpart I is added to read as follows:

Subpart I — Registration of Residential Mortgage Loan Originators

Subpart I — Registration of Residential Mortgage Loan Originators

§ 208.101 Authority, purpose, and scope.

(a) Authority. This subpart is issued by the Board of Governors of the Federal Reserve System (Board) pursuant to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, title V of the Housing and Economic Recovery Act of 2008 (S.A.F.E. Act) (Pub. L. 110-289, 122 Stat. 2654, 12 U.S.C. 5101 et seq.), 12 U.S.C. 248(a), 3106a(b)(1), and 3108(a).

(b) Purpose. This subpart implements the S.A.F.E. Act's Federal registration requirement for mortgage loan originators. The S.A.F.E. Act provides that the objectives of this registration include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of mortgage loan originators; enhancing consumer protections; reducing fraud in the residential mortgage loan origination process; and providing consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators.

(c) Scope. (1) In general. This subpart applies to member banks of the Federal Reserve System (other than national banks); their respective subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)(5)); branches and agencies of foreign banks (other than federal branches, Federal agencies and insured state branches of foreign banks), and commercial lending companies owned or controlled by foreign banks (collectively referred to in this subpart as banks), and their employees who act as mortgage loan originators.

(2) Exception. (i) This subpart and the requirements of sections 1504(a)(1)(A) and (2) of the S.A.F.E. Act do not apply to any employee of a bank if during the past 12 months:

(A) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and

(B) The bank employs mortgage loan originators who, while excepted from registration pursuant to paragraph (c)(2)(i)(A) of this section, in the aggregate, acted as a mortgage loan originator in connection with 25 or fewer residential mortgage loans.

(ii) Prior to engaging in mortgage loan origination activity that exceeds either the individual or the aggregate exception limit, a bank employee must register with the Registry pursuant to this subpart.

§ 208.102 Definitions.

For purposes of this subpart, the following definitions apply:

(a) Annual renewal period means November 1 through December 31 of each year.

(b)(1) Mortgage loan originator[7] means an individual who:

(i) Takes a residential mortgage loan application; and

(ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain.

(2) The term mortgage loan originator does not include:

(i) An individual who performs purely administrative or clerical tasks on behalf of an individual who is described in paragraph (b)(1) of this section;

(ii) An individual who only performs real estate brokerage activities (as defined in section

1503(3)(D) of the S.A.F.E. Act) and is licensed or registered as a real estate broker in accordance with applicable State law, unless the individual is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator in paragraph (b)(1) of this section; or

(iii) An individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).

(3) Administrative or clerical tasks means the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan.

(c) Nationwide Mortgage Licensing System and Registry or Registry means the system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the State licensing and registration of State-licensed mortgage loan originators and the registration of mortgage loan originators pursuant to section 1507 of the S.A.F.E. Act.

(d) Registered mortgage loan originator or registrant means any individual who:

(1) Meets the definition of mortgage loan originator and is an employee of a bank; and

(2) Is registered pursuant to this subpart with, and maintains a unique identifier through, the Registry.

(e) Residential mortgage loan means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act, 15 U.S.C. 1602(v)) or residential real estate upon which is constructed or intended to be constructed a dwelling, and includes refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans that meet the qualifications listed in this definition.

(f) Unique identifier means a number or other identifier that:

(1) Permanently identifies a registered mortgage loan originator;

(2) Is assigned by protocols established by the Nationwide Mortgage Licensing System and Registry, the Federal banking agencies, and the Farm Credit Administration to facilitate:

(i) Electronic tracking of mortgage loan originators; and

(ii) Uniform identification of, and public access to, the employment history of and the publicly adjudicated disciplinary and enforcement actions against mortgage loan originators; and

(3) Must not be used for purposes other than those set forth under the S.A.F.E. Act.

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[7] The Appendix to this subpart provides examples of activities that would, and would not, cause an employee to fall within this section's definition of mortgage loan originator.

§ 208.103 Registration of mortgage loan originators.

(a) Registration requirement. (1) Employee registration. Each employee of a bank who acts as a mortgage loan originator must register with the Registry, obtain a unique identifier, and maintain this registration in accordance with the requirements of this subpart. Any such employee who is not in compliance with the registration and unique identifier requirements set forth in this subpart is in violation of the S.A.F.E. Act and this subpart.

(2) Bank requirement. (i) In general. A bank that employs one or more individuals who act as a residential mortgage loan originator must require each employee who is a mortgage loan originator to register with the Registry, maintain this registration, and obtain a unique identifier in accordance with the requirements of this subpart.

(ii) Prohibition. A bank must not permit an employee of the bank who is subject to the registration requirements of this subpart to act as a mortgage loan originator unless such employee is registered with the Registry pursuant to this subpart.

(3) Implementation period for initial registration. An employee of a bank who is a mortgage loan originator must complete an initial registration with the Registry pursuant to this subpart within 180 days from the date that the Board provides public notice that the Registry is accepting registrations.

(4) Employees previously registered or licensed through the Registry. (i) In general. If an employee of a bank was registered or licensed through, and obtained a unique identifier from, the Registry prior to becoming an employee of the bank and has maintained this registration or license, the registration requirements of the S.A.F.E. Act and this subpart are deemed to be met, provided that:

(A) The employment information in paragraphs (d)(1)(i)(C) and (d)(1)(ii) of this section is updated and the requirements of paragraph (d)(2) of this section are met;

(B) New fingerprints of the employee are submitted to the Registry for a background check, as required by paragraph (d)(1)(xii) of this section;

(C) The bank information required in paragraphs (e)(1)(i) (to the extent the bank has not previously met these requirements) and (e)(2)(i) of this section is submitted to the Registry; and

(D) The registration is maintained pursuant to paragraphs (b) and (e)(1)(ii) of this section, as of the date that the employee is employed by the bank.

(ii) Implementation period for certain acquisitions, mergers or reorganizations. When registered or licensed mortgage loan originators become bank employees as a result of an acquisition, merger or reorganization transaction, the bank and employees must comply with the requirements of paragraphs (a)(4)(i)(A), (C), and (D) of this section within 60 days from the effective date of the acquisition, merger, or reorganization.

(b) Maintaining registration. (1) A mortgage loan originator who is registered with the Registry pursuant to paragraph (a) of this section must:

(i) Renew the registration during the annual renewal period, confirming the responses set forth in paragraphs (d)(1)(i) through (xi) of this section remain accurate and complete, and updating this information, as appropriate; and

(ii) Update the registration within 30 days of any of the following events:

(A) A change in the name of the registrant;

(B) The registrant ceases to be an employee of the bank; or

(C) The information required under paragraphs (d)(1)(iii) through (xi) of this section becomes inaccurate, incomplete, or out-of-date.

(2) A registered mortgage loan originator must maintain his or her registration, notwithstanding the originator's subsequent qualification for the exception set forth in § 208.101(c)(2), unless the individual is no longer engaged in the activity of a mortgage loan originator.

(c) Effective dates. (1) Initial registration. An initial registration pursuant to paragraph (a) of this section is effective on the date the registrant receives notification from the Registry that all information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

(2) Renewals or updates. A renewal or update pursuant to paragraph (b) of this section is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) of this section has been submitted and the renewal or update is complete.

(d) Required employee information. (1) In general. For purposes of the registration required by this section, a bank must require each employee who is a mortgage loan originator to submit to the Registry, or must submit on behalf of the employee, the following categories of information to the extent this information is collected by the Registry:

(i) Identifying information, including the employee's:

(A) Name and any other names used;

(B) Home address;

(C) Address of the employee's principal business location and business contact information;

(D) Social security number;

(E) Gender; and

(F) Date and place of birth;

(ii) Financial services-related employment history for the 10 years prior to the date of registration or renewal, including the date the employee became an employee of the bank;

(iii) Financial information for the 10 years prior to the date of registration or renewal constituting a history of any personal bankruptcy; business bankruptcy based upon events that occurred while the employee exercised control over an organization; denied, paid out, or revoked bonds; or unsatisfied judgments or liens against the employee;

(iv) Felony convictions or other final criminal actions involving a felony against the employee or organizations controlled by the employee; or misdemeanor convictions or other final misdemeanor actions against the employee or organizations controlled by the employee involving financial services, a financial services-related business, dishonesty, or breach of trust;

(v) Civil judicial actions against the employee in connection with financial services-related activities, dismissals with settlements, judicial findings that the employee violated financial services-related statutes or regulations, except for actions dismissed without a settlement agreement;

(vi) Actions or orders by a State or Federal regulatory agency or foreign financial regulatory authority that:

(A) Found the employee to have made a false statement or omission or been dishonest, unfair or unethical; to have been involved in a violation of a financial services-related regulation or statute; or to have been a cause of a financial services-related business having its authorization to do business denied, suspended, revoked or restricted;

(B) Are entered against the employee in connection with a financial services-related activity;

(C) Denied, suspended, or revoked the employee's registration or license to engage in a financial services-related activity; disciplined the employee or otherwise by order prevented the employee from associating with a financial services-related business or restricted the employee's activities; or

(D) Barred the employee from association with an entity regulated by the agency or authority or from engaging in a financial services-related business;

(vii) Final orders issued by a State or Federal regulatory agency or foreign financial regulatory authority based on violations of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct;

(viii) Revocation or suspension of the employee's authorization to act as an attorney, accountant, or State or Federal contractor;

(ix) Customer-initiated financial services-related arbitration or civil action against the employee that required action, including settlements;

(x) Disclosure of any voluntary or involuntary employment terminations resulting from allegations accusing the employee of violating a statute, regulation, or industry standard of conduct; fraud; dishonesty; theft; or the wrongful taking of property;

(xi) Any pending actions against the employee that could result in an action listed in paragraphs (d)(1)(iii) through (ix) of this section; and

(xii) Fingerprints of the employee, in digital form if practicable, collected by the employing institution less than three years prior to registration and any appropriate identifying information for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information in connection with a State and national criminal history background check.

(2) Employee authorization and attestation. An employee registering as a mortgage loan originator or renewing his or her registration under this subpart must:

(i) Authorize the Registry and the employing institution to obtain information related to any administrative, civil or criminal findings, to which the employee is a party, made by any governmental jurisdiction;

(ii) Attest to the correctness of all information required by paragraph (d) of this section, whether submitted by the employee or on behalf of the employee by the employing bank; and

(iii) Authorize the Registry to make available to the public information required by paragraphs (d)(1)(i)(A) and (C), (d)(1)(ii), (iv) – (ix) and (xi) of this section.

(e) Required bank information. A bank must submit the following information to the Registry.

(1) Bank record. (i) In connection with the initial registration of one or more mortgage loan originators:

(A) Name and main office address;

(B) Internal Revenue Service Employer Tax Identification Number (EIN);

(C) Research Statistics Supervision and Discount (RSSD) number, as issued by the Board;

(D) Identification of its primary Federal regulator;

(E) Name(s) and contact information of the individual(s) with authority to act as the bank's primary point of contact for the Registry;

(F) Name(s) and contact information of the individual(s) with authority to enter data required in paragraph (e) of this section on the Registry and who may delegate this authority to other bank employees, provided this individual and any delegated employee does not act as a mortgage loan originator; and

(G) If a subsidiary of a bank, indication that it is a subsidiary and the name of its parent bank.

(ii) A bank must update the information required by this paragraph (e) within 30 days of the date that this information becomes inaccurate.

(2) Employee information. In connection with the registration of each employee who acts as a mortgage loan originator:

(i) After the information required by paragraph (d) of this section has been submitted to the Registry, confirmation that it employs the registrant; and

(ii) Within 30 days of the date the registrant ceases to be an employee of the bank, notification that it no longer employs the registrant and the date the registrant ceased being an employee.

§ 208.104 Policies and procedures.

A bank that employs mortgage loan originators must adopt and follow written policies and procedures designed to assure compliance with this subpart. These policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the bank. At a minimum, these policies and procedures must:

(a) Establish a process for identifying which employees of the bank are required to be registered mortgage loan originators;

(b) Require that all employees of the bank who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this subpart and be instructed on how to comply with such requirements and procedures;

(c) Establish procedures to comply with the unique identifier requirements in § 208.105;

(d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;

(e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;

(f) Provide for independent testing for compliance with this subpart to be conducted by bank personnel or by an outside party;

(g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this subpart, or the bank's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and

(h) Establish a process for reviewing employee criminal history background reports received from the Registry in connection with § 208.103(d)(1)(xii), taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

§ 208.105 Use of unique identifier.

(a) The bank shall make the unique identifier(s) of its registered mortgage loan originator(s) available to consumers in a manner and method practicable to the institution.

(b) A registered mortgage loan originator shall provide his or her unique identifier to a consumer:

(1) Upon request;

(2) Before acting as a mortgage loan originator; and

(3) Through the originator's initial written communication with a consumer, if any.

Appendix A to Subpart I of Part 208— Examples of Mortgage Loan Originator Activities.

This Appendix provides examples to aid in the understanding of activities that would cause an employee of a bank to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive. They illustrate only the issue described and do not illustrate any other issues that may arise under this subpart. For the purposes of the examples below, the term "loan" refers to a residential mortgage loan.

(a) Taking a loan application: The following examples illustrate when an employee takes or does not take, a loan application.

(1) Taking an application includes: receiving information that is sufficient to determine whether the consumer qualifies for a loan, even if the employee has had no contact with the consumer and is not responsible for further verification of information.

(2) Taking an application does not include any of the following activities performed solely or in combination:

(i) Contacting a consumer to verify the information in the loan application by obtaining documentation, such as tax returns or payroll receipts;

(ii) Receiving a loan application through the mail and forwarding it, without review, to loan approval personnel; or

(iii) Assisting a consumer who is filling out an application by clarifying what type of information is necessary for the application or otherwise explaining the loan application process in response to consumer inquiries.

(b) Offering or negotiating terms of a loan: The following examples are designed to illustrate when an employee offers or negotiates terms of a loan, and conversely, what does not constitute offering or negotiating terms of a loan.

(1) Offering or negotiating the terms of a loan includes:

(i) Presenting a loan offer to a consumer for acceptance, either verbally or in writing, even if further verification of information is necessary and the offer is conditional; or

(ii) Responding to a consumer's request for a lower rate or lower points on a pending loan application by presenting to the consumer a revised loan offer, either verbally or in writing, that includes a lower interest rate or lower points than the original offer.

(2) Offering or negotiating terms of a loan does not include solely or in combination:

(i) Providing general explanations in response to consumer queries regarding qualification for a specific loan product, such as explaining loan terminology (i.e., debt-to-income ratio) or lending policies (i.e., the loan-to-value ratio policy of the bank);

(ii) In response to a consumer's request, informing a consumer of the loan rates that are publicly available such as on the bank's website for specific types of loan products without communicating to the consumer whether qualifications are met for that loan product;

(iii) Collecting information about a consumer in order to provide the consumer with information on loan products for which the consumer generally may qualify, without presenting a specific loan offer to the consumer for acceptance, either verbally or in writing;

(iv) Arranging the loan closing or other aspects of the loan process, including communicating with a consumer about those arrangements, provided that communication with the consumer only verifies loan terms already offered or negotiated; or

(v) Providing a consumer with information unrelated to loan terms, such as the best days of the month for scheduling loan closings at the bank.

(c) The following examples illustrate when an employee does or does not offer or negotiate terms of a loan "for compensation or gain."

(1) Offering or negotiating terms of a loan for compensation or gain includes engaging in any of the activities in paragraph (b)(1) of this Appendix in the course of carrying out employment duties, even if the employee does not receive a referral fee or commission or other special compensation for the loan.

(2) Offering or negotiating terms of a loan for compensation or gain does not include engaging in a seller-financed transaction for the employee's personal property that does not involve the bank.

4. Section 208.111 is amended by redesignating footnotes 7 and 8 as footnotes 8 and 9, respectively, and by revising newly designated footnote 9 to read as follows:

§ 208.111 Obligations concerning institutional customers.

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[9] *See* footnote 8 in paragraph (d) of this section.

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the preamble, the Federal Deposit Insurance Corporation proposes to amend subchapter B of chapter III of title 12 of the Code of Federal Regulations by amending part 365 as follows:

PART 365 – REAL ESTATE LENDING STANDARDS

1. The authority citation for part 365 is revised to read as follows:

Authority: 12 U.S.C. 1828(o) and 5101 et seq.

2. Sections 365.1 and 365.2 and Appendix A are placed under a new subpart A, and the heading for new subpart A is added to read as follows:

Subpart A – Real Estate Lending Standards

3. Section 365.1 is amended by removing "part" and adding "subpart" In its place.

4. Appendix A to Part 365 is redesignated as Appendix A to Subpart A of Part 365, and the heading is revised to read as follows:

Appendix A to Subpart A of Part 365 – Interagency Guidelines for Real Estate Lending Policies

5. New subpart B is added to read as follows:

Subpart B – Registration of Mortgage Loan Originators

Sec.

365.101 Authority, purpose, and scope.
365.102 Definitions.
365.103 Registration of mortgage loan originators.
365.104 Policies and procedures.
365.105 Use of unique identifier.

Appendix A to Subpart B of Part 365 – Examples of Mortgage Loan Originator Activities

Subpart B – Registration of Residential Mortgage Loan Originators

§ 365.101 Authority, purpose, and scope.

(a) Authority. This subpart is issued pursuant to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, title V of the Housing and Economic Recovery Act of 2008 (S.A.F.E. Act) (Pub. L. 110-289, 122 Stat. 2654, 12 U.S.C. 5101 et seq.).

(b) Purpose. This subpart implements the S.A.F.E. Act's Federal registration requirement for mortgage loan originators. The S.A.F.E. Act provides that the objectives of this registration include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of mortgage loan originators; enhancing consumer protections; reducing fraud in the residential mortgage loan origination process; and providing consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators.

(c) Scope. (1) In general. This subpart applies to insured state nonmember banks (including state-licensed insured branches of foreign banks) and their subsidiaries (except brokers, dealers, persons providing insurance, investment companies, and investment advisers) (collectively referred to in this subpart as insured state nonmember banks), and their employees who act as mortgage loan originators.

(2) Exception. (i) This subpart and the requirements of sections 1504(a)(1)(A) and (2) of the S.A.F.E. Act do not apply to any employee of an insured state nonmember bank if during the past 12 months:

(A) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and

(B) The insured state nonmember bank employs mortgage loan originators who, while excepted from registration pursuant to paragraph (c)(2)(i)(A) of this section, in the aggregate, acted as a mortgage loan originator in connection with 25 or fewer residential mortgage loans.

(ii) Prior to engaging in mortgage loan origination activity that exceeds either the individual or the aggregate exception limit, an insured state nonmember bank employee must register with the Registry pursuant to this subpart.

§ 365.102 Definitions.

For purposes of this subpart, the following definitions apply:

(a) Annual renewal period means November 1 through December 31 of each year.

(b)(1) Mortgage loan originator[1] means an individual who:

(i) Takes a residential mortgage loan application; and

(ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain.

(2) The term mortgage loan originator does not include:

(i) An individual who performs purely administrative or clerical tasks on behalf of an individual who is described in paragraph (b)(1) of this section;

(ii) An individual who only performs real estate brokerage activities (as defined in section 1503(3)(D) of the S.A.F.E. Act) and is licensed or registered as a real estate broker in accordance with applicable State law, unless the individual is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator in paragraph (b)(1) of this section; or

(iii) An individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).

(3) Administrative or clerical tasks means the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan.

(c) Nationwide Mortgage Licensing System and Registry or Registry means the system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the State licensing and registration of State-licensed mortgage loan originators and the registration of mortgage loan originators pursuant to section 1507 of the S.A.F.E. Act.

(d) Registered mortgage loan originator or registrant means any individual who:

(1) Meets the definition of mortgage loan originator and is an employee of an insured state nonmember bank; and

(2) Is registered pursuant to this subpart with, and maintains a unique identifier through, the Registry.

(e) Residential mortgage loan means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act, 15 U.S.C. 1602(v)) or residential real estate upon which is constructed or intended to be constructed a dwelling, and includes refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans that meet the qualifications listed in this definition.

(f) Unique identifier means a number or other identifier that:

(1) Permanently identifies a registered mortgage loan originator;

(2) Is assigned by protocols established by the Nationwide Mortgage Licensing System and Registry, the Federal banking agencies, and the Farm Credit Administration to facilitate:

(i) Electronic tracking of mortgage loan originators; and

(ii) Uniform identification of, and public access to, the employment history of and the publicly adjudicated disciplinary and enforcement actions against mortgage loan originators; and

(3) Must not be used for purposes other than those set forth under the S.A.F.E. Act.

[1] The Appendix to this subpart provides examples of activities that would, and would not, cause an employee to fall within this section's definition of mortgage loan originator.

§ 365.103 Registration of mortgage loan originators.

(a) Registration requirement. (1) Employee registration. Each employee of an insured state nonmember bank who acts as a mortgage loan originator must register with the Registry, obtain a unique identifier, and maintain this registration in accordance with the requirements of this subpart. Any such employee who is not in compliance with the registration and unique identifier requirements set forth in this subpart is in violation of the S.A.F.E. Act and this subpart.

(2) Insured state nonmember bank requirement. (i) In general. An insured state nonmember bank that employs one or more individuals who act as a residential mortgage loan originator must require each employee who is a mortgage loan originator to register with the Registry, maintain this registration, and obtain a unique identifier in accordance with the requirements of this subpart.

(ii) Prohibition. An insured state nonmember bank must not permit an employee of the bank who is subject to the registration requirements of this subpart to act as a mortgage loan originator unless such employee is registered with the Registry pursuant to this subpart.

(3) Implementation period for initial registration. An employee of an insured state nonmember bank who is a mortgage loan originator must complete an initial registration with the Registry pursuant to this subpart within 180 days from the date that the FDIC provides public notice that the Registry is accepting registrations.

(4) Employees previously registered or licensed through the Registry. (i) In general. If an employee of an insured state nonmember bank was registered or licensed through, and obtained a unique identifier from, the Registry prior to becoming an employee of the bank and has maintained this registration or license, the registration requirements of the S.A.F.E. Act and this subpart are deemed to be met, provided that:

(A) The employment information in paragraphs (d)(1)(i)(C) and (d)(1)(ii) of this section is updated and the requirements of paragraph (d)(2) of this section are met;

(B) New fingerprints of the employee are submitted to the Registry for a background check, as required by paragraph (d)(1)(xii) of this section;

(C) The insured state nonmember bank information required in paragraphs (e)(1)(i) (to the extent the bank has not previously met these requirements) and (e)(2)(i) of this section is submitted to the Registry; and

(D) The registration is maintained pursuant to paragraphs (b) and (e)(1)(ii) of this section, as of the date that the employee is employed by the bank.

(ii) Implementation period for certain acquisitions, mergers or reorganizations. When registered or licensed mortgage loan originators become insured state nonmember bank employees as a result of an acquisition, merger or reorganization transaction, the bank and employees must comply with the requirements of paragraphs (a)(4)(i)(A), (C), and (D) of this section within 60 days from the effective date of the acquisition, merger, or reorganization.

(b) Maintaining registration. (1) A mortgage loan originator who is registered with the Registry pursuant to paragraph (a) of this section must:

(i) Renew the registration during the annual renewal period, confirming the responses set forth in paragraphs (d)(1)(i) through (xi) of this section remain accurate and complete, and updating this information, as appropriate; and

(ii) Update the registration within 30 days of any of the following events:

(A) A change in the name of the registrant;

(B) The registrant ceases to be an employee of the insured state nonmember bank; or

(C) The information required under paragraphs (d)(1)(iii) through (xi) of this section becomes inaccurate, incomplete, or out-of-date.

(2) A registered mortgage loan originator must maintain his or her registration, notwithstanding the originator's subsequent qualification for the exception set forth in § 365.101(c)(2), unless the individual is no longer engaged in the activity of a mortgage loan originator.

(c) Effective dates. (1) Initial registration. An initial registration pursuant to paragraph (a) of this section is effective on the date the registrant receives notification from the Registry that all information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

(2) Renewals or updates. A renewal or update pursuant to paragraph (b) of this section is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) of this section has been submitted and the renewal or update is complete.

(d) Required employee information. (1) In general. For purposes of the registration required by this section, an insured state nonmember bank must require each employee who is a mortgage loan originator to submit to the Registry, or must submit on behalf of the employee, the following categories of information to the extent this information is collected by the Registry:

(i) Identifying information, including the employee's:

(A) Name and any other names used;

(B) Home address;

(C) Address of the employee's principal business location and business contact information;

(D) Social security number;

(E) Gender; and

(F) Date and place of birth;

(ii) Financial services-related employment history for the 10 years prior to the date of registration or renewal, including the date the employee became an employee of the bank;

(iii) Financial information for the 10 years prior to the date of registration or renewal constituting a history of any personal bankruptcy; business bankruptcy based upon events that occurred while the employee exercised control over an organization; denied, paid out, or revoked bonds; or unsatisfied judgments or liens against the employee;

(iv) Felony convictions or other final criminal actions involving a felony against the employee or organizations controlled by the employee; or misdemeanor convictions or other final misdemeanor actions against the employee or organizations controlled by the employee involving financial services, a financial services-related business, dishonesty, or breach of trust;

(v) Civil judicial actions against the employee in connection with financial services-related activities, dismissals with settlements, judicial findings that the employee violated financial services-related statutes or regulations, except for actions dismissed without a settlement agreement;

(vi) Actions or orders by a State or Federal regulatory agency or foreign financial regulatory authority that:

(A) Found the employee to have made a false statement or omission or been dishonest, unfair or unethical; to have been involved in a violation of a financial services-related regulation or statute; or to have been a cause of a financial services-related business having its authorization to do business denied, suspended, revoked or restricted;

(B) Are entered against the employee in connection with a financial services-related activity;

(C) Denied, suspended, or revoked the employee's registration or license to engage in a financial services-related activity; disciplined the employee or otherwise by order prevented the employee from associating with a financial services-related business or restricted the employee's activities; or

(D) Barred the employee from association with an entity regulated by the agency or authority or from engaging in a financial services-related business;

(vii) Final orders issued by a State or Federal regulatory agency or foreign financial regulatory authority based on violations of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct;

(viii) Revocation or suspension of the employee's authorization to act as an attorney, accountant, or State or Federal contractor;

(ix) Customer-initiated financial services-related arbitration or civil action against the employee that required action, including settlements;

(x) Disclosure of any voluntary or involuntary employment terminations resulting from allegations accusing the employee of violating a statute, regulation, or industry standard of conduct; fraud; dishonesty; theft; or the wrongful taking of property;

(xi) Any pending actions against the employee that could result in an action listed in paragraphs (d)(1)(iii) through (ix) of this section; and

(xii) Fingerprints of the employee, in digital form if practicable, collected by the employing institution less than three years prior to registration and any appropriate identifying information for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information in connection with a State and national criminal history background check.

(2) Employee authorization and attestation. An employee registering as a mortgage loan originator or renewing his or her registration under this subpart must:

(i) Authorize the Registry and the employing institution to obtain information related to any administrative, civil or criminal findings, to which the employee is a party, made by any governmental jurisdiction;

(ii) Attest to the correctness of all information required by paragraph (d) of this section, whether submitted by the employee or on behalf of the employee by the employing bank; and

(iii) Authorize the Registry to make available to the public information required by paragraphs (d)(1)(i)(A) and (C), (d)(1)(ii), (iv) – (ix) and (xi) of this section.

(e) Required bank information. An insured state nonmember bank must submit the following information to the Registry.

(1) Bank record. (i) In connection with the initial registration of one or more mortgage loan originators:

(A) Name and main office address;

(B) Internal Revenue Service Employer Tax Identification Number (EIN);

(C) Research Statistics Supervision and Discount (RSSD) number, as issued by the Board of Governors of the Federal Reserve System;

(D) Identification of its primary Federal regulator;

(E) Name(s) and contact information of the individual(s) with authority to act as the bank's primary point of contact for the Registry;

(F) Name(s) and contact information of the individual(s) with authority to enter data required in paragraph (e) of this section on the Registry and who may delegate this authority to other bank employees, provided this individual and any delegated employee does not act as a mortgage loan originator; and

(G) If a subsidiary of an insured state nonmember bank, indication that it is a subsidiary and the name of its parent bank.

(ii) An insured state nonmember bank must update the information required by this paragraph (e) within 30 days of the date that this information becomes inaccurate.

(2) Employee information. In connection with the registration of each employee who acts as a mortgage loan originator:

(i) After the information required by paragraph (d) of this section has been submitted to the Registry, confirmation that it employs the registrant; and

(ii) Within 30 days of the date the registrant ceases to be an employee of the bank, notification that it no longer employs the registrant and the date the registrant ceased being an employee.

§ 365.104 Policies and procedures.

An insured state nonmember bank that employs mortgage loan originators must adopt and follow written policies and procedures designed to assure compliance with this subpart. These policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the bank. At a minimum, these policies and procedures must:

(a) Establish a process for identifying which employees of the bank are required to be registered mortgage loan originators;

(b) Require that all employees of the insured state nonmember bank who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this subpart and be instructed on how to comply with such requirements and procedures;

(c) Establish procedures to comply with the unique identifier requirements in § 365.105;

(d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;

(e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;

(f) Provide for independent testing for compliance with this subpart to be conducted by bank personnel or by an outside party;

(g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this subpart, or the bank's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and

(h) Establish a process for reviewing employee criminal history background reports received from the Registry in connection with § 365.103(d)(1)(xii), taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

§ 365.105 Use of unique identifier.

(a) An insured state nonmember bank shall make the unique identifier(s) of its registered mortgage loan originator(s) available to consumers in a manner and method practicable to the institution.

(b) A registered mortgage loan originator shall provide his or her unique identifier to a consumer:

(1) Upon request;

(2) Before acting as a mortgage loan originator; and

(3) Through the originator's initial written communication with a consumer, if any.

Appendix A to Subpart B of Part 365 - Examples of Mortgage Loan Originator Activities.

This Appendix provides examples to aid in the understanding of activities that would cause an employee of an insured state nonmember bank to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive. They illustrate only the issue described and do not illustrate any other issues that may arise under this subpart. For the purposes of the examples below, the term "loan" refers to a residential mortgage loan.

(a) <u>Taking a loan application</u>: The following examples illustrate when an employee takes or does not take, a loan application.

(1) Taking an application includes: receiving information that is sufficient to determine whether the consumer qualifies for a loan, even if the employee has had no contact with the consumer and is not responsible for further verification of information.

(2) Taking an application does not include any of the following activities performed solely or in combination:

(i) Contacting a consumer to verify the information in the loan application by obtaining documentation, such as tax returns or payroll receipts;

(ii) Receiving a loan application through the mail and forwarding it, without review, to loan approval personnel; or

(iii) Assisting a consumer who is filling out an application by clarifying what type of information is necessary for the application or otherwise explaining the loan application process in response to consumer inquiries.

(b) <u>Offering or negotiating terms of a loan</u>: The following examples are designed to illustrate when an employee offers or negotiates terms of a loan, and conversely, what does not constitute offering or negotiating terms of a loan.

(1) Offering or negotiating the terms of a loan includes:

(i) Presenting a loan offer to a consumer for acceptance, either verbally or in writing, even if further verification of information is necessary and the offer is conditional; or

(ii) Responding to a consumer's request for a lower rate or lower points on a pending loan application by presenting to the consumer a revised loan offer, either verbally or in writing, that includes a lower interest rate or lower points than the original offer.

(2) Offering or negotiating terms of a loan does not include solely or in combination:

(i) Providing general explanations in response to consumer queries regarding qualification for a specific loan product, such as explaining loan terminology (i.e., debt-to-income ratio) or lending policies (i.e., the loan-to-value ratio policy of the insured state nonmember bank);

(ii) In response to a consumer's request, informing a consumer of the loan rates that are publicly available such as on the insured state nonmember bank's website for specific types of loan products without communicating to the consumer whether qualifications are met for that loan product;

(iii) Collecting information about a consumer in order to provide the consumer with information on loan products for which the consumer generally may qualify, without presenting a specific loan offer to the consumer for acceptance, either verbally or in writing;

(iv) Arranging the loan closing or other aspects of the loan process, including communicating with a consumer about those arrangements, provided that communication with the consumer only verifies loan terms already offered or negotiated; or

(v) Providing a consumer with information unrelated to loan terms, such as the best days of the month for scheduling loan closings at the bank.

(c) The following examples illustrate when an employee does or does not offer or negotiate terms of a loan "for compensation or gain."

(1) Offering or negotiating terms of a loan for compensation or gain includes engaging in any of the activities in paragraph (b)(1) of this Appendix in the course of carrying out employment duties, even if the employee does not receive a referral fee or commission or other special compensation for the loan.

(2) Offering or negotiating terms of a loan for compensation or gain does not include engaging in a seller-financed transaction for the employee's personal property that does not involve the insured state nonmember bank.

Office of Thrift Supervision

12 CFR Chapter V

Authority and Issuance

For the reasons set forth in the preamble, chapter V of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 563 – SAVINGS ASSOCIATIONS - OPERATIONS

1. The authority citation for part 563 is revised to read as follows:

Authority: 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1820, 1828, 1831o, 3806, 5101 et seq.; 31 U.S.C. 5318; 42 U.S.C. 4106.

2. Add Subpart D to part 563 to read as follows:

Subpart D—Registration of Residential Mortgage Loan Originators

Sec.

Subpart D—Registration of Residential Mortgage Loan Originators

§ 563.101 Authority, purpose, and scope.

(a) Authority. This subpart is issued pursuant to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, title V of the Housing and Economic Recovery Act of 2008 (S.A.F.E. Act) (Pub. L. 110-289, 122 Stat. 2654, 12 U.S.C. 5101 et seq.).

(b) Purpose. This subpart implements the S.A.F.E. Act's Federal registration requirement for mortgage loan originators. The S.A.F.E. Act provides that the objectives of this registration include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of mortgage loan originators; enhancing consumer protections; reducing fraud in the residential mortgage loan origination process; and providing consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators.

(c) Scope. (1) In general. This subpart applies to savings associations and their operating subsidiaries (collectively referred to in this subpart as savings associations), and their employees who act as mortgage loan originators.

(2) Exception. (i) This subpart and the requirements of section 1504(a)(1)(A) and (2) of the S.A.F.E. Act do not apply to any employee of a savings association if during the past 12 months:

(A) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and

(B) The savings association does not employ mortgage loan originators who, while excepted from registration pursuant to paragraph (c)(2)(i)(A) of this section, in the aggregate, acted as a mortgage loan originator in connection with more than 25 residential mortgage loans.

(ii) Prior to engaging in mortgage loan origination activity that exceeds either the individual or the aggregate exception limit, a savings association employee must register with the Registry pursuant to this subpart.

§ 563.102 Definitions.

For purposes of this subpart D, the following definitions apply:

(a) Annual renewal period means November 1 through December 31 of each year.

(b)(1) Mortgage loan originator[1] means an individual who:

(i) Takes a residential mortgage loan application; and

(ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain.

(2) The term mortgage loan originator does not include:

(i) An individual who performs purely administrative or clerical tasks on behalf of an individual who is described in paragraph (b)(1) of this section;

(ii) An individual who only performs real estate brokerage activities (as defined in section 1503(3)(D) of the S.A.F.E. Act) and is licensed or registered as a real estate broker in accordance with applicable State law, unless the individual is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator in paragraph (b)(1) of this section; or

(iii) An individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).

(3) Administrative or clerical tasks means the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan.

(c) Nationwide Mortgage Licensing System and Registry or Registry means the system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the State licensing and registration of State-licensed mortgage loan originators and the registration of mortgage loan originators pursuant to section 1507 of the S.A.F.E. Act.

(d) Registered mortgage loan originator or registrant means any individual who:

(1) Meets the definition of mortgage loan originator and is an employee of a savings association; and

(2) Is registered pursuant to this subpart with, and maintains a unique identifier through, the Registry.

(e) Residential mortgage loan means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act) or residential real estate upon which is constructed or intended to be constructed a dwelling, and includes refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans that meet the qualifications listed in this definition.

(f) Unique identifier means a number or other identifier that:

(1) Permanently identifies a registered mortgage loan originator;

(2) Is assigned by protocols established by the Nationwide Mortgage Licensing System and Registry, the Federal banking agencies, and the Farm Credit Administration to facilitate:

(i) Electronic tracking of mortgage loan originators; and

(ii) Uniform identification of, and public access to, the employment history of and the publicly adjudicated disciplinary and enforcement actions against mortgage loan originators; and

(3) Must not be used for purposes other than those set forth under the S.A.F.E. Act.

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[1] The Appendix to this subpart provides examples of activities that would, and would not, cause an employee to fall within this section's definition of mortgage loan originator.

§ 563.103 Registration of mortgage loan originators.

(a) Registration requirement. (1) Employee registration. Each employee of a savings association who acts as a mortgage loan originator must register with the Registry, obtain a unique identifier, and maintain this registration in accordance with the requirements of this subpart. Any such employee who is not in compliance with the registration and unique identifier requirements set forth in this subpart is in violation of the S.A.F.E. Act and this subpart.

(2) Savings association requirement. (i) In general. A savings association that employs one or more individuals who act as a residential mortgage loan originator must require each employee who is a mortgage loan originator to register with the Registry, maintain this registration, and obtain a unique identifier in accordance with the requirements of this subpart.

(ii) Prohibition. A savings association must not permit an employee of the association who is subject to the registration requirements of this subpart to act as a mortgage loan originator unless such employee is registered with the Registry pursuant to this subpart.

(3) Implementation period for initial registration. An employee of a savings association who is a mortgage loan originator must complete an initial registration with the Registry pursuant to this subpart within 180 days from the date that the OTS provides public notice that the Registry is accepting registrations.

(4) Employees previously registered or licensed through the Registry. (i) In general. If an employee of a savings association was registered or licensed through, and obtained a unique identifier from, the Registry prior to becoming an employee of the association and has maintained this registration or license, the registration requirements of the S.A.F.E. Act and this subpart are deemed to be met, provided that:

(A) The employment information in paragraphs (d)(1)(i)(C) and (d)(1)(ii) of this section is updated and the requirements of paragraph (d)(2) of this section are met;

(B) New fingerprints of the employee are submitted to the Registry for a background check, as required by paragraph (d)(1)(xii);

(C) The savings association information required in paragraphs (e)(1)(i) (to the extent the association has not previously met these requirements) and (e)(2)(i) of this section is submitted to the Registry; and

(D) The registration is maintained pursuant to paragraphs (b) and (e)(1)(ii) of this section, as of the date that the employee is employed by the association.

(ii) Implementation period for certain acquisitions, mergers or reorganizations. When registered or licensed mortgage loan originators become savings association employees as a result of an acquisition, merger or reorganization transaction, the association and employees must comply with the requirements of paragraphs (a)(4)(i)(A), (C), and (D) of this section within 60 days from the effective date of the acquisition, merger, or reorganization.

(b) Maintaining registration. (1) A mortgage loan originator who is registered with the Registry pursuant to paragraph (a) of this section must:

(i) Renew the registration during the annual renewal period, confirming the responses set forth in paragraphs (d)(1)(i) through (xi) of this section remain accurate and complete, and updating this information, as appropriate; and

(ii) Update the registration within 30 days of any of the following events:

(A) A change in the name of the registrant;

(B) The registrant ceases to be an employee of the savings association; or

(C) The information required under paragraphs (d)(1)(iii) through (xi) of this section becomes inaccurate, incomplete, or out-of-date.

(2) A registered mortgage loan originator must maintain his or her registration, notwithstanding the originator's subsequent qualification for the exception set forth in § 563.101(c)(2), unless the individual is no longer engaged in the activity of a mortgage loan originator.

(c) Effective dates. (1) Initial registration. An initial registration pursuant to paragraph (a) of this section is effective on the date the registrant receives notification from the Registry that all information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

(2) Renewals or updates. A renewal or update pursuant to paragraph (b) of this section is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) and of this section has been submitted and the renewal or update is complete.

(d) Required employee information. (1) In general. For purposes of the registration required by this section, a savings association must require each employee who is a mortgage loan originator to submit to the Registry, or must submit on behalf of the employee, the following categories of information to the extent this information is collected by the Registry:

(i) Identifying information, including the employee's:

(A) Name and any other names used;

(B) Home address;

(C) Address of the employee's principal business location and business contact information;

(D) Social security number;

(E) Gender; and

(F) Date and place of birth;

(ii) Financial services-related employment history for the 10 years prior to the date of registration or renewal, including the date the employee became an employee of the association;

(iii) Financial information for the 10 years prior to the date of registration or renewal constituting a history of any personal bankruptcy; business bankruptcy based upon events that occurred while the employee exercised control over an organization; denied, paid out, or revoked bonds; or unsatisfied judgments or liens against the employee;

(iv) Felony convictions or other final criminal actions involving a felony against the employee or organizations controlled by the employee; or misdemeanor convictions or other final misdemeanor actions against the employee or organizations controlled by the employee involving financial services, a financial services-related business, dishonesty, or breach of trust;

(v) Civil judicial actions against the employee in connection with financial services-related activities, dismissals with settlements, judicial findings that the employee violated financial services-related statutes or regulations, except for actions dismissed without a settlement agreement;

(vi) Actions or orders by a State or Federal regulatory agency or foreign financial regulatory authority that:

(A) Found the employee to have made a false statement or omission or been dishonest, unfair or unethical; to have been involved in a violation of a financial services-related regulation or statute; or to have been a cause of a financial services-related business having its authorization to do business denied, suspended, revoked or restricted;

(B) Are entered against the employee in connection with a financial services-related activity;

(C) Denied, suspended, or revoked the employee's registration or license to engage in a financial services-related activity; disciplined the employee or otherwise by order prevented the employee from associating with a financial services-related business or restricted the employee's activities; or

(D) Barred the employee from association with an entity regulated by the agency or authority or from engaging in a financial services-related business;

(vii) Final orders issued by a State or Federal regulatory agency or foreign financial regulatory authority based on violations of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct;

(viii) Revocation or suspension of the employee's authorization to act as an attorney, accountant, or State or Federal contractor;

(ix) Customer-initiated financial services-related arbitration or civil action against the employee that required action, including settlements;

(x) Disclosure of any voluntary or involuntary employment terminations resulting from allegations accusing the employee of violating a statute, regulation, or industry standard of conduct; fraud; dishonesty; theft; or the wrongful taking of property;

(xi) Any pending actions against the employee that could result in an action listed in paragraphs (d)(1)(iii) through (ix) of this section; and

(xii) Fingerprints of the employee, in digital form if practicable, collected by the employing savings association less than three years prior to registration and any appropriate identifying information for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information in connection with a State and national criminal history background check;

(2) Employee authorization and attestation. An employee registering as a mortgage loan originator or renewing his or her registration under this subpart must:

(i) Authorize the Registry and the employing institution to obtain information related to any administrative, civil or criminal findings, to which the employee is a party, made by any governmental jurisdiction;

(ii) Attest to the correctness of all information required by paragraph (d) of this section, whether submitted by the employee or on behalf of the employee by the employing savings association; and

(iii) Authorize the Registry to make available to the public information required by paragraphs (d)(1)(i)(A) and (C), (d)(1)(ii),(iv), (v), (vi), (vii), (viii), (ix), and (xi) of this section.

(e) Required savings association information. A savings association must submit the following information to the Registry.

(1) Savings association record. (i) In connection with the initial registration of one or more mortgage loan originators:

(A) Name and main office address;

(B) Internal Revenue Service Employer Tax Identification Number (EIN);

(C) Research Statistics Supervision and Discount (RSSD) number, as issued by the Board of Governors of the Federal Reserve System;

(D) Identification of its primary Federal regulator;

(E) Name(s) and contact information of the individual(s) with authority to act as the savings association's primary point of contact for the Registry;

(F) Name(s) and contact information of the individual(s) with authority to enter data required in paragraph (e) of this section on the Registry and who may delegate this authority to other savings association employees, provided this individual and any delegated employee does not act as a mortgage loan originator;

(G) If an operating subsidiary of a savings association, indication that it is a subsidiary and the name of its parent savings association.

(ii) A savings association must update the information required by this paragraph (e) within 30 days of the date that this information becomes inaccurate.

(2) Employee information. In connection with the registration of each employee who acts as a mortgage loan originator:

(i) After the information required by paragraph (d) of this section has been submitted to the Registry, confirmation that it employs the registrant; and

(ii) Within 30 days of the date the registrant ceases to be an employee of the savings association, notification that it no longer employs the registrant and the date the registrant ceased being an employee.

§ 563.104 Policies and procedures.

A savings association that employs mortgage loan originators must adopt and follow written policies and procedures designed to assure compliance with this subpart. These policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the savings association. At a minimum, these policies and procedures must:

(a) Establish a process for identifying which employees of the savings association are required to be registered mortgage loan originators;

(b) Require that all employees of the savings association who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this subpart and be instructed on how to comply with such requirements and procedures;

(c) Establish procedures to comply with the unique identifier requirements in § 563.105;

(d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;

(e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;

(f) Provide for independent testing for compliance with this subpart to be conducted by savings association personnel or by an outside party;

(g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this subpart, or the savings association's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and

(h) Establish a process for reviewing employee criminal history background reports received from the Registry in connection with § 563.103(d)(1)(xii) of this section, taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

§ 563.105 Use of unique identifier.

(a) The savings association shall make the unique identifier(s) of its registered mortgage loan originator(s) available to consumers in a manner and method practicable to the institution.

(b) A registered mortgage loan originator shall provide his or her unique identifier to a consumer:

(1) Upon request;

(2) Before acting as a mortgage loan originator; and

(3) Through the originator's initial written communication with a consumer, if any.

Appendix A to Subpart D of Part 563 - Examples of Mortgage Loan Originator Activities.

This Appendix provides examples to aid in the understanding of activities that would cause an employee of a savings association to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive. They illustrate only the issue described and do not illustrate any other issues that may arise under this subpart. For the purposes of the examples below, the term "loan" refers to a residential mortgage loan.

(a) Taking a loan application: The following examples illustrate when an employee takes or does not take, a loan application.

(1) Taking an application includes: receiving information that is sufficient to determine whether the consumer qualifies for a loan, even if the employee has had no contact with the consumer and is not responsible for further verification of information.

(2) Taking an application does not include any of the following activities performed solely or in combination:

(i) Contacting a consumer to verify the information in the loan application by obtaining documentation, such as tax returns or payroll receipts;

(ii) Receiving a loan application through the mail and forwarding it, without review, to loan approval personnel; or

(iii) Assisting a consumer who is filling out an application by clarifying what type of information is necessary for the application or otherwise explaining the loan application process in response to consumer inquiries.

(b) Offering or negotiating terms of a loan: The following examples are designed to illustrate when an employee offers or negotiates terms of a loan, and conversely, what does not constitute offering or negotiating terms of a loan.

(1) Offering or negotiating the terms of a loan includes:

(i) Presenting a loan offer to a consumer for acceptance, either verbally or in writing, even if further verification of information is necessary and the offer is conditional; or

(ii) Responding to a consumer's request for a lower rate or lower points on a pending loan application by presenting to the consumer a revised loan offer, either verbally or in writing, that includes a lower interest rate or lower points than the original offer.

(2) Offering or negotiating terms of a loan does not include solely or in combination:

(i) Providing general explanations in response to consumer queries regarding qualification for a specific loan product, such as explaining loan terminology (i.e., debt-to-income ratio) or lending policies (i.e., the loan-to-value ratio policy of the savings association);

(ii) In response to a consumer's request, informing a consumer of the loan rates that are publicly available such as on the savings association's website for specific types of loan products without communicating to the consumer whether qualifications are met for that loan product;

(iii) Collecting information about a consumer in order to provide the consumer with information on loan products for which the consumer generally may qualify, without presenting a specific loan offer to the consumer for acceptance, either verbally or in writing;

(iv) Arranging the loan closing or other aspects of the loan process, including communicating with a consumer about those arrangements, provided that communication with the consumer only verifies loan terms already offered or negotiated; or

(v) Providing a consumer with information unrelated to loan terms, such as the best days of the month for scheduling loan closings at the savings association.

(c) The following examples illustrate when an employee does or does not offer or negotiate terms of a loan "for compensation or gain."

(1) Offering or negotiating terms of a loan for compensation or gain includes engaging in any of the activities in paragraph (b)(1) of this Appendix in the course of carrying out employment duties, even if the employee does not receive a referral fee or commission or other special compensation for the loan.

(2) Offering or negotiating terms of a loan for compensation or gain does not include engaging in a seller-financed transaction for the employee's personal property that does not involve the savings association.

Farm Credit Administration

12 CFR Chapter VI

Authority and Issuance

For the reasons set forth in the preamble, chapter VI of title 12 of the Code of Federal Regulations is proposed to be amended by adding new part 610 to chapter VI to read as follows:

PART 610- REGISTRATION OF MORTGAGE LOAN ORIGINATORS

Sec.
610.101 Authority, purpose, and scope.
610.102 Definitions.
610.103 Registration of mortgage loan originators.
610.104 Policies and procedures.
610.105 Use of unique identifier.
Appendix A to Part 610 -- Examples of Mortgage Loan Originator Activities

Authority: Secs. 1.5, 1.7, 1.9, 1.10, 1.11, 1.13, 2.2, 2.4, 2.12, 5.9, 5.17, 7.2, 7.6, 7.8 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2017, 2018, 2019, 2021, 2073, 2075, 2093, 2243, 2252, 2279a-2, 2279b, 2279c-10); and Secs. 1501 et seq. of the S.A.F.E. Act (12 U.S.C. 5101 et seq.)

§ 610.101 Authority, purpose, and scope.

(a) *Authority*. This part is issued pursuant to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, title V of the Housing and Economic Recovery Act of 2008 (S.A.F.E. Act) (Pub. L. 110-289, 122 Stat. 2654 (2008), 12 U.S.C. 5101 et seq.).

(b) *Purpose.* This part implements the S.A.F.E. Act's Federal registration requirement for mortgage loan originators. The S.A.F.E. Act provides that the objectives of this registration include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of mortgage loan originators; enhancing consumer protections; reducing fraud in the residential mortgage loan origination process; and providing consumers with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, mortgage loan originators.

(c) *Scope*.

(1) *In general.* This part applies to any Farm Credit System lending institution that actually originates residential mortgage loans pursuant to its authority under sections 1.9(3), 1.11, or 2.4(a) and (b) of the Farm Credit Act of 1971, as amended, and their employees who act as mortgage loan originators.

(2) *Exception.*

(i) This part and the requirements of sections 1504(a)(1)(A) and (2) of the S.A.F.E. Act do not apply to any employee of a Farm Credit System institution if during the past 12 months:

(A) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and

(B) The Farm Credit System institution employs mortgage loan originators who, while excepted from registration pursuant to paragraph (c)(2)(i)(A) of this section, in the aggregate, acted as a mortgage loan originator in connection with 25 or fewer residential mortgage loans.

(ii) Prior to engaging in mortgage loan origination activity that exceeds either the individual or the aggregate exception limit, a Farm Credit System institution employee must register with the Registry pursuant to this part.

§ 610.102 Definitions.

For purposes of this part, the following definitions apply:

(a) *Annual renewal period* means November 1 through December 31 of each year.

(b)(1) *Mortgage loan originator* [1] means an individual who:

(i) Takes a residential mortgage loan application; and

(ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain.

(2) The term *mortgage loan originator* does not include:

(i) An individual who performs purely administrative or clerical tasks on behalf of an individual who is described in paragraph (b)(1) of this section;

(ii) An individual who only performs real estate brokerage activities (as defined in section 1503(3)(D) of the S.A.F.E. Act) and is licensed or registered as a real estate broker in accordance with applicable State law, unless the individual is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator in paragraph (b)(1) of this section; or

(iii) An individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).

(3) *Administrative or clerical tasks* means the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan.

(c) *Nationwide Mortgage Licensing System and Registry* or *Registry* means the system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the State licensing and registration of State-licensed mortgage loan originators and the registration of mortgage loan originators pursuant to section 1507 of the S.A.F.E. Act.

(d) *Registered mortgage loan originator* or *registrant* means any individual who:

(1) Meets the definition of mortgage loan originator and is an employee of a Farm Credit System institution; and

(2) Is registered pursuant to this part with, and maintains a unique identifier through, the Registry.

(e) *Residential mortgage loan* means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act, 15 U.S.C. 1602(v)) or residential real estate upon which is constructed or intended to be constructed a dwelling, and includes refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans that meet the qualifications listed in this definition. This definition does not amend or supersede § 613.3030(c) of this chapter.

(f) *Unique identifier* means a number or other identifier that:

(1) Permanently identifies a registered mortgage loan originator;

(2) Is assigned by protocols established by the Nationwide Mortgage Licensing System and Registry, the Federal banking agencies, and the Farm Credit Administration to facilitate:

(i) Electronic tracking of mortgage loan originators; and

(ii) Uniform identification of, and public access to, the employment history of and the publicly adjudicated disciplinary and enforcement actions against mortgage loan originators; and

(3) Must not be used for purposes other than those set forth under the S.A.F.E. Act.

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[1] The Appendix to this part provides examples of activities that would, and would not, cause an employee to fall within this section's definition of mortgage loan originator.

§ 610.103 Registration of mortgage loan originators.

(a) *Registration requirement*.

(1) *Employee registration*. Each employee of a Farm Credit System institution who acts as a mortgage loan originator must register with the Registry, obtain a unique identifier, and maintain this registration in accordance with the requirements of this part. Any such employee who is not in compliance with the registration and unique identifier requirements set forth in this part is in violation of the S.A.F.E. Act and this part.

(2) *Farm Credit System institution requirement*.

(i) *In general*. A Farm Credit System institution that employs one or more individuals who act as a residential mortgage loan originator must require each employee who is a mortgage loan originator to register with the Registry, maintain this registration, and obtain a unique identifier in accordance with the requirements of this part.

(ii) *Prohibition*. A Farm Credit System institution must not permit an employee who is subject to the registration requirements of this part to act as a mortgage loan originator unless such employee is registered with the Registry pursuant to this part.

(3) *Implementation period for initial registration*. An employee of a Farm Credit System institution who is a mortgage loan originator must complete an initial registration with the Registry pursuant to this part within 180 days from the date that the Farm Credit Administration provides public notice that the Registry is accepting registrations.

(4) *Employees previously registered or licensed through the Registry*.

(i) *In general*. If an employee of a Farm Credit System institution was registered or licensed through, and obtained a unique identifier from, the Registry prior to becoming an employee of the Farm Credit System institution and has maintained this registration or license, the registration requirements of the S.A.F.E. Act and this part are deemed to be met, provided that:

(A) The employment information in paragraphs (d)(1)(i)(C) and (d)(1)(ii) of this section is updated and the requirements of paragraph (d)(2) of this section are met;

(B) New fingerprints of the employee are submitted to the Registry for a background check, as required by paragraph (d)(1)(xii) of this section;

(C) The Farm Credit System institution information required in paragraphs (e)(1)(i) (to the extent the Farm Credit System institution has not previously met these requirements) and (e)(2)(i) of this section is submitted to the Registry; and

(D) The registration is maintained pursuant to paragraphs (b) and (e)(1)(ii) of this section, as of the date that the employee is employed by the Farm Credit System institution.

(ii) *Implementation period for certain acquisitions, mergers or reorganizations*. When registered or licensed mortgage loan originators become employees of another Farm Credit System institution as a result of a consolidation, merger or reorganization transaction, the Farm Credit System institution and employee must comply with the requirements of paragraphs (a)(4)(i)(A), (C), and (D) of this section within 60 days from the effective date of the consolidation, merger, or reorganization.

(b) *Maintaining registration*.

(1) A mortgage loan originator who is registered with the Registry pursuant to paragraph (a) of this section must:

(i) Renew the registration during the annual renewal period, confirming the responses set forth in paragraphs (d)(1)(i) through (xi) of this section remain accurate and complete, and updating this information, as appropriate; and

(ii) Update the registration within 30 days of any of the following events:

(A) A change in the name of the registrant;

(B) The registrant ceases to be an employee of the Farm Credit System institution; or

(C) The information required under paragraphs (d)(1)(iii) through (xi) of this section becomes inaccurate, incomplete, or out-of-date.

(2) A registered mortgage loan originator must maintain his or her registration, notwithstanding the originator's subsequent qualification for the exception set forth in § 610.101(c)(2), unless the individual is no longer engaged in the activity of a mortgage loan originator.

(c) *Effective dates.*

(1) *Initial registration*. An initial registration pursuant to paragraph (a) of this section is effective on the date the registrant receives notification from the Registry that all information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

(2) *Renewals or updates.* A renewal or update pursuant to paragraph (b) of this section is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) of this section has been submitted and the renewal or update is complete.

(d) *Required employee information*.

(1) *In general*. For purposes of the registration required by this section, a Farm Credit System institution must require each employee who is a mortgage loan originator to submit to the Registry, or must submit on behalf of the employee, the following categories of information to the extent this information is collected by the Registry:

(i) Identifying information, including the employee's:

(A) Name and any other names used;

(B) Home address;

(C) Address of the employee's principal business location and business contact information;

(D) Social security number;

(E) Gender; and

(F) Date and place of birth;

(ii) Financial services-related employment history for the 10 years prior to the date of registration or renewal, including the date the employee became an employee of the Farm Credit System institution;

(iii) Financial information for the 10 years prior to the date of registration or renewal constituting a history of any personal bankruptcy; business bankruptcy based upon events that occurred while the employee exercised control over an organization; denied, paid out, or revoked bonds; or unsatisfied judgments or liens against the employee;

(iv) Felony convictions or other final criminal actions involving a felony against the employee or organizations controlled by the employee; or misdemeanor convictions or other final misdemeanor actions against the employee or organizations controlled by the employee involving financial services, a financial services-related business, dishonesty, or breach of trust;

(v) Civil judicial actions against the employee in connection with financial services-related activities, dismissals with settlements, judicial findings that the employee violated financial services-related statutes or regulations, except for actions dismissed without a settlement agreement;

(vi) Actions or orders by a State or Federal regulatory agency or foreign financial regulatory authority that:

(A) Found the employee to have made a false statement or omission or been dishonest, unfair or unethical; to have been involved in a violation of a financial services-related regulation or statute; or to have been a cause of a financial services-related business having its authorization to do business denied, suspended, revoked or restricted;

(B) Are entered against the employee in connection with a financial services-related activity;

(C) Denied, suspended, or revoked the employee's registration or license to engage in a financial services-related activity; disciplined the employee or otherwise by order prevented the employee from associating with a financial services-related business or restricted the employee's activities; or

(D) Barred the employee from association with an entity regulated by the agency or authority or from engaging in a financial services-related business;

(vii) Final orders issued by a State or Federal regulatory agency or foreign financial regulatory authority based on violations of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct;

(viii) Revocation or suspension of the employee's authorization to act as an attorney, accountant, or State or Federal contractor;

(ix) Customer-initiated financial services-related arbitration or civil action against the employee that required action, including settlements;

(x) Disclosure of any voluntary or involuntary employment terminations resulting from allegations accusing the employee of violating a statute, regulation, or industry standard of conduct; fraud; dishonesty; theft; or the wrongful taking of property;

(xi) Any pending actions against the employee that could result in an action listed in paragraphs (d)(1)(iii) through (ix) of this section; and

(xii) Fingerprints of the employee, in digital form if practicable, collected by the employing institution less than three years prior to registration and any appropriate identifying information for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information in connection with a State and national criminal history background check.

(2) *Employee authorization and attestation*. An employee registering as a mortgage loan originator or renewing his or her registration under this part must:

(i) Authorize the Registry and the employing institution to obtain information related to any administrative, civil or criminal findings, to which the employee is a party, made by any governmental jurisdiction;

(ii) Attest to the correctness of all information required by paragraph (d) of this section, whether submitted by the employee or on behalf of the employee by the employing Farm Credit System institution; and

(iii) Authorize the Registry to make available to the public information required by paragraphs (d)(1)(i)(A) and (C), (d)(1)(ii), (iv) – (ix) and (xi) of this section.

(e) *Required information*. A Farm Credit System institution must submit the following information to the Registry.

(1) *Farm Credit System institution record*.

(i) In connection with the initial registration of one or more mortgage loan originators:

(A) Name and main office address;

(B) Internal Revenue Service Employer Tax Identification Number (EIN);

(C) Research Statistics Supervision and Discount (RSSD) number, as issued by the Board of Governors of the Federal Reserve System;

(D) Identification of its primary Federal regulator;

(E) Name(s) and contact information of the individual(s) with authority to act as the Farm Credit System institution's primary point of contact for the Registry;

(F) Name(s) and contact information of the individual(s) with authority to enter data required in paragraph (e) of this section on the Registry and who may delegate this authority to other employees of the Farm Credit System institution, provided this individual and any delegated employee does not act as a mortgage loan originator; and

(G) If an operating subsidiary of an agricultural credit association, indication that it is a subsidiary and the name of its parent agricultural credit association.

(ii) A Farm Credit System institution must update the information required by this paragraph (e) within 30 days of the date that this information becomes inaccurate.

(2) *Employee information*. In connection with the registration of each employee who acts as a mortgage loan originator:

(i) After the information required by paragraph (d) of this section has been submitted to the Registry, confirmation that it employs the registrant; and

(ii) Within 30 days of the date the registrant ceases to be an employee of the Farm Credit System institution, notification that it no longer employs the registrant and the date the registrant ceased being an employee.

§ 610.104 Policies and procedures.

A Farm Credit System institution that employs mortgage loan originators must adopt and follow written policies and procedures designed to assure compliance with this part. These policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the Farm Credit System institution. At a minimum, these policies and procedures must:

(a) Establish a process for identifying which employees of the Farm Credit System institution are required to be registered mortgage loan originators;

(b) Require that all employees of the Farm Credit System institution who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this part and be instructed on how to comply with such requirements and procedures;

(c) Establish procedures to comply with the unique identifier requirements in § 610.105;

(d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;

(e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;

(f) Provide for independent testing for compliance with this part to be conducted by Farm Credit System institution personnel or by an outside party;

(g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this part, or the Farm Credit System institution's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and

(h) Establish a process for reviewing employee criminal history background reports received from the Registry in connection with § 610.103(d)(1)(xii), taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

§ 610.105 Use of unique identifier.

(a) The Farm Credit System institution shall make the unique identifier(s) of its registered mortgage loan originator(s) available to consumers in a manner and method practicable to the institution.

(b) A registered mortgage loan originator shall provide his or her unique identifier to a consumer:

(1) Upon request;

(2) Before acting as a mortgage loan originator; and

(3) Through the originator's initial written communication with a consumer, if any.

Appendix A to Part 610 - Examples of Mortgage Loan Originator Activities.

This Appendix provides examples to aid in the understanding of activities that would cause an employee of a Farm Credit System institution to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive. They illustrate only the issue described and do not illustrate any other issues that may arise under this part. For the purposes of the examples below, the term "loan" refers to a residential mortgage loan.

(a) *Taking a loan application:* The following examples illustrate when an employee takes or does not take, a loan application.

(1) Taking an application includes: receiving information that is sufficient to determine whether the consumer qualifies for a loan, even if the employee has had no contact with the consumer and is not responsible for further verification of information.

(2) Taking an application does not include any of the following activities performed solely or in combination:

(i) Contacting a consumer to verify the information in the loan application by obtaining documentation, such as tax returns or payroll receipts;

(ii) Receiving a loan application through the mail and forwarding it, without review, to loan approval personnel; or

(iii) Assisting a consumer who is filling out an application by clarifying what type of information is necessary for the application or otherwise explaining the loan application process in response to consumer inquiries.

(b) *Offering or negotiating terms of a loan:* The following examples are designed to illustrate when an employee offers or negotiates terms of a loan, and conversely, what does not constitute offering or negotiating terms of a loan.

(1) Offering or negotiating the terms of a loan includes:

(i) Presenting a loan offer to a consumer for acceptance, either verbally or in writing, even if further verification of information is necessary and the offer is conditional; or

(ii) Responding to a consumer's request for a lower rate or lower points on a pending loan application by presenting to the consumer a revised loan offer, either verbally or in writing, that includes a lower interest rate or lower points than the original offer.

(2) Offering or negotiating terms of a loan does not include solely or in combination:

(i) Providing general explanations in response to consumer queries regarding qualification for a specific loan product, such as explaining loan terminology (i.e., debt-to-income ratio) or lending policies (i.e., the loan-to-value ratio policy of the Farm Credit System institution);

(ii) In response to a consumer's request, informing a consumer of the loan rates that are publicly available such as on the Farm Credit System institution's website for specific types of loan products without communicating to the consumer whether qualifications are met for that loan product;

(iii) Collecting information about a consumer in order to provide the consumer with information on loan products for which the consumer generally may qualify, without presenting a specific loan offer to the consumer for acceptance, either verbally or in writing;

(iv) Arranging the loan closing or other aspects of the loan process, including communicating with a consumer about those arrangements, provided that communication with the consumer only verifies loan terms already offered or negotiated; or

(v) Providing a consumer with information unrelated to loan terms, such as the best days of the month for scheduling loan closings at the Farm Credit System institution.

(c) The following examples illustrate when an employee does or does not offer or negotiate terms of a loan "for compensation or gain."

(1) Offering or negotiating terms of a loan for compensation or gain includes engaging in any of the activities in paragraph (b)(1) of this Appendix in the course of carrying out employment duties, even if the employee does not receive a referral fee or commission or other special compensation for the loan.

(2) Offering or negotiating terms of a loan for compensation or gain does not include engaging in a seller-financed transaction for the employee's personal property that does not involve the Farm Credit System institution.

National Credit Union Administration

12 CFR Chapter VII

Authority and Issuance

For the reasons stated in the preamble, the National Credit Union Administration proposes to amend chapter VII of title 12 of the Code of Federal Regulations to add a new part 761 as follows:

PART 761 – REGISTRATION OF RESIDENTIAL MORTGAGE LOAN ORIGINATORS

Sec.

761.101 Authority, purpose, and scope.

761.102 Definitions.

761.103 Registration of mortgage loan originators.

761.104 Policies and procedures.

761.105 Use of unique identifier.

Appendix A to Part 761 - Examples of Mortgage Loan Originator Activities.

Authority: 12 U.S.C. 1751 et seq. and 5101 et seq.

§ 761.101 Authority, purpose, and scope.

(a) Authority. The National Credit Union Administration is issuing part 761 under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, title V of the Housing and Economic Recovery Act of 2008 (S.A.F.E. Act) (Pub. L. 110-289, 122 Stat. 2654, 12 U.S.C. 5101 et seq.).

(b) Purpose. This part implements the S.A.F.E. Act's federal registration requirement for mortgage loan originators. The S.A.F.E. Act provides that the objectives of this registration include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of loan originators; enhancing member protections; reducing fraud in the residential mortgage loan origination process; and providing members with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, loan originators.

(c) Scope. (1) In general. This part applies to federally insured credit unions and their employees who act as mortgage loan originators.

(2) Exception. (i) This part and the requirements of section 1504(a)(1)(A) and (2) of the S.A.F.E. Act do not apply to any employee of a federally insured credit union if during the past 12 months:

(A) The employee acted as a mortgage loan originator for 5 or fewer residential mortgage loans; and

(B) The credit union employs mortgage loan originators who, while excepted from registration under paragraph (c)(2)(i)(A) of this section, in the aggregate, acted as a mortgage loan originator in connection with 25 or fewer residential mortgage loans.

(ii) Prior to engaging in mortgage loan origination activity that exceeds either the individual or the aggregate exception limit, a credit union employee must register with the Registry under this part.

§ 761.102 Definitions.

For purposes of this part, the following definitions apply:

(a) Annual renewal period means November 1 through December 31 of each year.

(b)(1) Mortgage loan originator[1] means an individual who:

(i) Takes a residential mortgage loan application; and

(ii) Offers or negotiates terms of a residential mortgage loan for compensation or gain.

(2) The term mortgage loan originator does not include:

(i) An individual who performs purely administrative or clerical tasks on behalf of an individual who is described in paragraph (b)(1) of this section;

(ii) An individual who only performs real estate brokerage activities (as defined in section 1503(3)(D) of the S.A.F.E. Act) and is licensed or registered as a real estate broker in accordance with applicable state law, unless the individual is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator, and meets the definition of mortgage loan originator in paragraph (b)(1) of this section; or

(iii) An individual or entity solely involved in extensions of credit related to timeshare plans, as that term is defined in 11 U.S.C. 101(53D).

(3) Administrative or clerical tasks means the receipt, collection, and distribution of information common for the processing or underwriting of a residential mortgage loan and communication with a member to obtain information necessary for the processing or underwriting of a residential mortgage loan.

(c) Nationwide Mortgage Licensing System and Registry or Registry means the system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the state licensing and registration of state-licensed mortgage loan originators and the registration of mortgage loan originators under section 1507 of the S.A.F.E. Act.

(d) Registered mortgage loan originator or registrant means any individual who:

(1) Meets the definition of mortgage loan originator and is a credit union employee; and

(2) Is registered under this part with, and maintains a unique identifier through, the Registry.

(e) Residential mortgage loan means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act (15 U.S.C. 1602(v))) or residential real estate upon which is constructed or intended to be constructed a dwelling, and includes refinancings, reverse mortgages, home equity lines of credit and other first and second lien loans that meet the qualifications listed in this definition.

(f) Unique identifier means a number or other identifier that:

(1) Permanently identifies a registered mortgage loan originator;

(2) Is assigned by protocols established by the Nationwide Mortgage Licensing System and Registry, the Federal banking agencies, and the Farm Credit Administration to facilitate:

(i) Electronic tracking of mortgage loan originators; and

(ii) Uniform identification of, and public access to, the employment history of and the publicly adjudicated disciplinary and enforcement actions against mortgage loan originators; and

(3) Must not be used for purposes other than those under the S.A.F.E. Act.

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[1] The Appendix to this part provides examples of activities that would, and would not, cause an employee to fall within this section's definition of mortgage loan originator.

§ 761.103 Registration of mortgage loan originators.

(a) Registration requirement. (1) Employee registration. Each credit union employee who acts as a mortgage loan originator must register with the Registry, obtain a unique identifier, and maintain this registration in accordance with the requirements of this part. Any such employee who is not in compliance with the registration and unique identifier requirements in this part is in violation of the S.A.F.E. Act and this part.

(2) Credit union requirement. (i) In general. A credit union that employs one or more individuals who act as a residential mortgage loan originator must require each employee who is a mortgage loan originator to register with the Registry, maintain this registration, and obtain a unique identifier in accordance with the requirements of this part.

(ii) Prohibition. A credit union must not permit its employee who is subject to this part's registration requirements to act as a mortgage loan originator unless such employee is registered with the Registry under this part.

(3) Implementation period for initial registration. A credit union employee who is a mortgage loan originator must complete an initial registration with the Registry under this part within 180 days from the date that the National Credit Union Administration provides public notice that the Registry is accepting registrations.

(4) Employees previously registered or licensed through the Registry. (i) In general. If a credit union employee was registered or licensed through, and obtained a unique identifier from, the Registry prior to becoming a credit union employee and has maintained this registration or license, the registration requirements of the S.A.F.E. Act and this part are deemed to be met, provided that:

(A) The employment information in paragraphs (d)(1)(i)(C) and (d)(1)(ii) of this section is updated and the requirements of paragraph (d)(2) of this section are met;

(B) New fingerprints of the employee are submitted to the Registry for a background check, as required by paragraph (d)(1)(xii) of this section;

(C) The credit union information required in paragraphs (e)(1)(i) (to the extent the credit union has not previously met these requirements) and (e)(2)(i) of this section is submitted to the Registry; and

(D) The registration is maintained under paragraphs (b) and (e)(1)(ii) of this section, as of the date that the employee is employed by the credit union.

(ii) Implementation period for certain acquisitions, mergers or reorganizations. When registered or licensed mortgage loan originators become credit union employees as a result of an acquisition, merger or reorganization transaction, the credit union and employee must comply with the requirements of paragraphs (a)(4)(i)(A), (C), and (D) of this section within 60 days from the effective date of the acquisition, merger, or reorganization.

(b) Maintaining registration. (1) A mortgage loan originator who is registered with the Registry under paragraph (a) of this section must:

(i) Renew the registration during the annual renewal period, confirming the responses set forth in paragraphs (d)(1)(i) through (xi) of this section remain accurate and complete, and updating this information, as appropriate; and

(ii) Update the registration within 30 days of any of the following events:

(A) A change in the name of the registrant;

(B) The registrant ceases to be a credit union employee; or

(C) The information required under paragraphs (d)(1)(iii) through (xi) of this section becomes inaccurate, incomplete, or out of date.

(2) A registered mortgage loan originator must maintain his or her registration, notwithstanding the originator's subsequent qualification for the exception in § 761.101(c)(2), unless the individual is no longer engaged in the activity of a mortgage loan originator.

(c) Effective dates. (1) Initial registration. An initial registration under paragraph (a) of this section is effective on the date the registrant receives notification from the Registry that all information required by paragraphs (d) and (e) of this section has been submitted and the registration is complete.

(2) Renewals or updates. A renewal or update under paragraph (b) of this section is effective on the date the registrant receives notification from the Registry that all applicable information required by paragraphs (b) and (e) of this section has been submitted and the renewal or update is complete.

(d) Required employee information. (1) In general. For purposes of the registration required by this section, a credit union must require each employee who is a mortgage loan originator to submit to the Registry, or must submit on behalf of the employee, the following categories of information to the extent this information is collected by the Registry:

(i) Identifying information, including the employee's;

(A) Name and any other names used;

(B) Home address;

(C) Address of the employee's principal business location and business contact information;

(D) Social security number;

(E) Gender; and

(F) Date and place of birth;

(ii) Financial services-related employment history for the 10 years prior to the date of registration or renewal, including the date the employee became a credit union employee;

(iii) Financial information for the 10 years prior to the date of registration or renewal constituting a history of any personal bankruptcy; business bankruptcy based upon events that occurred while the employee exercised control over an organization; denied, paid out, or revoked bonds; or unsatisfied judgments or liens against the employee;

(iv) Felony convictions or other final criminal actions involving a felony against the employee or organizations controlled by the employee; or misdemeanor convictions or other final misdemeanor actions against the employee or organizations controlled by the employee involving financial services, a financial services-related business, dishonesty, or breach of trust;

(v) Civil judicial actions against the employee in connection with financial services-related activities, dismissals with settlements, judicial findings that the employee violated financial services-related statutes or regulations, except for actions dismissed without a settlement agreement;

(vi) Actions or orders by a state or federal regulatory agency or foreign financial regulatory authority that:

(A) Found the employee to have made a false statement or omission or been dishonest, unfair or unethical; to have been involved in a violation of a financial services-related regulation or statute; or to have been a cause of a financial services-related business having its authorization to do business denied, suspended, revoked or restricted;

(B) Are entered against the employee in connection with a financial services-related activity;

(C) Denied, suspended, or revoked the employee's registration or license to engage in a financial services-related activity; disciplined the employee or otherwise by order prevented the employee from associating with a financial services-related business or restricted the employee's activities; or

(D) Barred the employee from association with an entity regulated by the agency or authority or from engaging in a financial services-related business;

(vii) Final orders issued by a state or federal regulatory agency or foreign financial regulatory authority based on violations of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct;

(viii) Revocation or suspension of the employee's authorization to act as an attorney, accountant, or state or federal contractor;

(ix) Customer-initiated financial services-related arbitration or civil action against the employee that required action, including settlements;

(x) Disclosure of any voluntary or involuntary employment terminations resulting from allegations accusing the employee of violating a statute, regulation, or industry standard of conduct; fraud; dishonesty; theft; or the wrongful taking of property;

(xi) Any pending actions against the employee that could result in an action listed in paragraphs (d)(1)(iii) through (ix) of this section; and

(xii) Fingerprints of the employee, in digital form if practicable, collected by the employing credit union less than three years prior to registration and any appropriate identifying information for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information in connection with a state and national criminal history background check;

(2) Employee authorization and attestation. An employee registering as a mortgage loan originator or renewing his or her registration under this part must:

(i) Authorize the Registry and the employing credit union to obtain information related to any administrative, civil or criminal findings, to which the employee is a party, made by any governmental jurisdiction;

(ii) Attest to the correctness of all information required by paragraph (d) of this section, whether submitted by the employee or on behalf of the employee by the employing credit union; and

(iii) Authorize the Registry to make available to the public information required by paragraphs (d)(1)(i)(A) and (C), (d)(1)(ii), (iv) – (ix) and (xi) of this section.

(e) Required credit union information. A credit union must submit the following information to the Registry:

(1) Credit union record. (i) In connection with the initial registration of one or more mortgage loan originators:

(A) Name and main office address;

(B) Internal Revenue Service Employer Tax Identification Number (EIN);

(C) Research Statistics Supervision and Discount (RSSD) number, as issued by the Board of Governors of the Federal Reserve System;

(D) Identification of the National Credit Union Administration as its primary Federal regulator;

(E) Name(s) and contact information of the individual(s) with authority to act as the credit union's primary point of contact for the Registry;

(F) Name(s) and contact information of the individual(s) with authority to enter data required in paragraph (e) of this section on the Registry and who may delegate this authority to other credit union employees, provided this individual and any delegated employee does not act as a mortgage loan originator.

(ii) A credit union must update the information required by this paragraph (e) within 30 days of the date that this information becomes inaccurate.

(2) Employee information. In connection with the registration of each employee who acts as a mortgage loan originator:

(i) After the information required by paragraph (d) of this section has been submitted to the Registry, confirmation that it employs the registrant; and

(ii) Within 30 days of the date the registrant ceases to be a credit union employee, notification that it no longer employs the registrant and the date the registrant ceased being an employee.

§ 761.104 Policies and procedures.

A credit union that employs mortgage loan originators must adopt and follow written policies and procedures designed to assure compliance with this part. These policies and procedures must be appropriate to the nature, size, complexity and scope of the mortgage lending activities of the credit union. At a minimum, these policies and procedures must:

(a) Establish a process for identifying which credit union employees are required to be registered mortgage loan originators;

(b) Require that all credit union employees who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this part and be instructed on how to comply with such requirements and procedures;

(c) Establish procedures to comply with the unique identifier requirements in § 761.105;

(d) Establish reasonable procedures for confirming the adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records;

(e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures;

(f) Provide for independent testing for compliance with this part to be conducted by credit union personnel or by an outside party;

(g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this part, or the credit union's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; and

(h) Establish a process for reviewing employee criminal history background reports received from the Registry in connection with § 761.103(d)(1)(xii), taking appropriate action consistent with applicable law and rules with respect to these reports, and for maintaining records of these reports and actions taken with respect to applicable employees.

§ 761.105 Use of unique identifier.

(a) The credit union shall make the unique identifier(s) of its registered mortgage loan originator(s) available to members in a manner and method practicable to the credit union.

(b) A registered mortgage loan originator shall provide his or her unique identifier to a member:

(1) Upon request;

(2) Before acting as a mortgage loan originator; and

(3) Through the originator's initial written communication with a member, if any.

Appendix A to Part 761 - Examples of Mortgage Loan Originator Activities.

This Appendix provides examples to aid in the understanding of activities that would cause a credit union employee to fall within or outside the definition of mortgage loan originator. The examples in this Appendix are not all inclusive. They illustrate only the issue described and do not illustrate any other issues that may arise under this part. For the purposes of the examples below, the term "loan" refers to a residential mortgage loan.

(a) <u>Taking a loan application</u>: The following examples illustrate when an employee takes or does not take, a loan application.

(1) Taking an application includes: receiving information that is sufficient to determine whether the member qualifies for a loan, even if the employee has had no contact with the member and is not responsible for further verification of information.

(2) Taking an application does not include any of the following activities performed solely or in combination:

(i) Contacting a member to verify the information in the loan application by obtaining documentation, such as tax returns or payroll receipts;

(ii) Receiving a loan application through the mail and forwarding it, without review, to loan approval personnel; or

(iii) Assisting a member who is filling out an application by clarifying what type of information is necessary for the application or otherwise explaining the loan application process in response to member inquiries.

(b) <u>Offering or negotiating terms of a loan</u>: The following examples are designed to illustrate when an employee offers or negotiates terms of a loan, and conversely, what does not constitute offering or negotiating terms of a loan.

(1) Offering or negotiating the terms of a loan includes:

(i) Presenting a loan offer to a member for acceptance, either verbally or in writing, even if further verification of information is necessary and the offer is conditional; or

(ii) Responding to a member's request for a lower rate or lower points on a pending loan application by presenting to the member a revised loan offer, either verbally or in writing, that includes a lower interest rate or lower points than the original offer.

(2) Offering or negotiating terms of a loan does not include solely or in combination:

(i) Providing general explanations in response to member queries regarding qualification for a specific loan product, such as explaining loan terminology (i.e., debt-to-income ratio) or lending policies (i.e., the loan-to-value ratio policy of the credit union);

(ii) In response to a member's request, informing a member of the loan rates that are publicly available such as on the credit union's website for specific types of loan products without communicating to the member whether qualifications are met for that loan product;

(iii) Collecting information about a member in order to provide the member with information on loan products for which the member generally may qualify, without presenting a specific loan offer to the member for acceptance, either verbally or in writing;

(iv) Arranging the loan closing or other aspects of the loan process, including communicating with a member about those arrangements, provided that communication with the member only verifies loan terms already offered or negotiated; or

(v) Providing a member with information unrelated to loan terms, such as the best days of the month for scheduling loan closings at the credit union.

(c) The following examples illustrate when an employee does or does not offer or negotiate terms of a loan "for compensation or gain":

(1) Offering or negotiating terms of a loan for compensation or gain includes engaging in any of the activities in paragraph (b)(1) of this Appendix in the course of carrying out employment duties, even if the employee does not receive a referral fee or commission or other special compensation for the loan.

(2) Offering or negotiating terms of a loan for compensation or gain does not include engaging in a seller-financed transaction for the employee's personal property that does not involve the credit union.

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE OF PROPOSED RULEMAKING ON REGISTRATION OF MORTGAGE LOAN ORIGINATORS]

Date: 5/27/09

John C. Dugan
Comptroller of the Currency.

By the order of the Board of Governors of the Federal Reserve System, May 28, 2009.

Robert deV. Frierson,
Deputy Secretary of the Board.
Billing Code: 6210-01-P

By order of the Board of Directors.
Dated at Washington, DC, the 29th day of May, 2009.
Federal Deposit Insurance Corporation.

Robert E. Feldman
Executive Secretary

SEAL

Dated: May 28, 2009

By the Office of Thrift Supervision,

John E. Bowman,
Acting Director.

Date: May 28, 2009

Roland E. Smith
Secretary,
Farm Credit Administration Board.

By the National Credit Union Administration Board on May 26, 2009.

Mary Rupp,
Secretary of the Board.

74 FR 28597, 06/17/2009

Handbook Mailing HM-09-4

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 619, 620, and 621

RIN 3052-AC35

Definitions; Disclosure to Shareholders; Accounting and Reporting Requirements; Disclosure and Accounting Requirements

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) issues this final rule amending FCA's regulations related to disclosure and reporting practices of Farm Credit System (System) institutions. This rule updates references to accounting terminology, streamlines requirements for filing quarterly reports and the content of the annual report to shareholders, and updates the requirements for maintaining an allowance for loan losses. The amendments ensure that FCA regulations are consistent with System structural changes and are updated to include changes to accounting and reporting standards.

EFFECTIVE DATE: This regulation will be effective 30 days after publication in the Federal Register during which either or both Houses of Congress are in session. We will publish a notice of the effective date in the Federal Register.

FOR FURTHER INFORMATION CONTACT:

Thomas R. Risdal, Senior Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434,

or

Robert Taylor, Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this final rule are to:

- Clarify FCA regulations related to disclosure and reporting practices of System institutions; and

- Ensure that FCA regulations are consistent with System structural changes and updated to include changes to accounting and reporting standards.

II. Background

The Farm Credit Amendments Act of 1985 (1985 Amendments)[1] added provisions to the Farm Credit Act of 1971, as amended (Act),[2] requiring FCA to regulate the disclosure and reporting practices of System institutions. In keeping with this provision, we published a proposed regulation in the Federal Register (73 FR 70921) on November 24, 2008, to amend parts 619, 620, and 621 affecting references to accounting terminology, requirements for the content of the annual report to shareholders, requirements for filing quarterly reports to shareholders, and requirements for maintaining an allowance for loan losses. We also proposed certain other clarifications and technical changes to our reporting and disclosure regulations. The proposed rule was published with a 60-day comment period, which closed on January 23, 2009.

III. Comments and Our Response

We received three comment letters on the proposed rule. Of the comment letters received, one was from the Federal Farm Credit Banks Funding Corporation (Funding Corporation) on behalf of the Farm Credit System's Accounting Standards Workgroup, one was from the Farm Credit Council (FCC) acting for its membership, and one was from a System association. In general, the commenters supported the proposed rule, but suggested additional changes to our rules. The commenters stated the suggested changes would allow for additional flexibility in meeting disclosure requirements. We discuss the comments to our proposed rule and provide our responses below. Those provisions of the proposed rule that did not receive comments are finalized as proposed.

A. Generally Accepted Auditing Standards [§§ 619.9270(e) and 621.2(d)]

We received no comments on our proposal to replace the language in § 621.2(d) referring to Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) with a reference to generally accepted auditing standards. We also received no comments on our proposed conforming change in § 619.9270(e) to replace the reference to AICPA with a reference to the authoritative body governing overall audit quality. We final these changes as proposed.

B. Signatures on Financial Reports [§ 620.3(b)(3)]

We received no comments on our proposal to remove the reference to reports of condition and performance from the signature requirements of § 620.3(b)(3). We finalize the change as proposed.

C. Contents of the Annual Report to Shareholders; Incorporation by Reference [§ 620.5(a) through (e)]

We received three comments supporting our proposal to allow the information required by § 620.5(a) through (e) to be incorporated by reference to the Management's Discussion and Analysis (MD&A) section. The commenters also suggested that we allow incorporation by reference in other areas of the report, not just the MD&A.

While we received support for the proposed change to § 620.5, we have determined it is unnecessary to change our existing rules and withdraw the proposed change. We originally proposed a change to allow incorporation in the MD&A the annual report items contained in paragraphs (a) through

(e) of § 620.5. We, in part, made this proposal because of the existing introductory language of § 620.5 stating that the annual report "must contain the following items in substantially the same order." However, existing § 620.2(d) provides that information in any part of the annual report may be incorporated by reference in answer to any other item of the report. In consideration of this language and the introductory language of § 620.5, we believe institutions are already authorized under the provisions of § 620.2(d) to incorporate the information of any required section of the annual report in another section, if the institution desires to do so. However, to ensure compliance the introductory language of § 620.5, institutions applying the provisions of § 620.2(d) will need to maintain the annual report section headings, as identified in § 620.5, and state under the heading where the "answer" may be found, i.e. the location where the reader may find the information.

D. Description of Business; Significant Developments [§ 620.5(a)(4)]

We received no comments on the proposal to require the disclosure of significant developments that had or could have material impact on patronage and dividends. We finalize the change as proposed.

However, we received three comments suggesting that the current requirement to report significant developments for the last 5 years be limited to the last 3 years. The commenters explained that such a change would be consistent with the requirement in § 620.5(m) to furnish financial statements and related footnotes for the last 3 years. The commenters also explained that the continuation of the 5-year disclosure requirement would provide no additional relevant information to the reader. While we consider the suggested change to our rule worth additional consideration, we did not propose this change. We cannot, in this final rulemaking, make the change without providing additional notice and comment because it does not constitute a logical outgrowth of the proposed rulemaking. We will, however, consider this issue in a future rulemaking.

E. Description of Business; the Institution's Interdependent Relationship with its Funding Bank [§ 620.5(a)(10)]

We proposed removing language that may be interpreted as limiting disclosures of certain interdependent relationships, including removal of paragraph (a)(10)(v). We also proposed new language for paragraph (a)(10) that captures a broader relationship between associations and their funding banks, including the elements of paragraph (a)(10)(v). We received no comments on our proposal and final these changes as proposed.

F. Description of Liabilities; Description of Statutory Responsibility for Repayment of Obligations Issued by the Farm Credit System Financial Assistance Corporation [§ 620.5(e)(4)]

We received no comments on our proposal to remove a remaining reference in § 620.5(e)(4) to the Farm Credit System Financial Assistance Corporation (FAC), which is no longer a chartered entity. We final this change as proposed.

G. Selected Financial Data; Associations that are not Direct Lender Associations [§ 620.5(f)(2)]

We received no comments on our proposal to remove § 620.5(f)(2) addressing associations that are not direct lender associations. All System associations are now direct lenders. We final this change as proposed.

H. Description of Funding Sources [§ 620.5(g)(3)(i)(A)]

We received no comments on our proposed clarification that § 620.5(g))(3)(i)(A) applies to all debt obligations held by each System institution, not just the consolidated System-wide debt and bond obligations. We final this change as proposed.

I. Listing of Directors and Senior Officers and their Terms of Office [§ 620.5(h)(1)]

We received no comments on the proposal to require disclosure of the date each senior officer commenced employment in his/her current position. We are finalizing this change as proposed.

We did receive three comments on this section suggesting changes not otherwise proposed. The commenters suggested requiring disclosure of prior positions held, if in the current position less than 5 years, explaining that it would provide useful information. The commenters contend that without this information the experience of the senior officer would be understated. We believe the commenters' concerns are sufficiently addressed by the requirements in § 620.5(h)(2). However, if institutions wish to disclose more information than that required by regulation, such additional disclosures may be made, provided that the disclosures comply with § 620.3(a).

J. Director Compensation [§ 620.5(i)(1)]

We received no comments on our proposal to clarify that the disclosures required by § 620.5(i)(1) apply to all directors who served in that capacity during the fiscal year, including those who resigned from the board or whose terms expired during the fiscal year. We final this change as proposed.

K. Fees Paid to the Qualified Public Accountant Engaged to Conduct the Financial Statement Audit [§ 620.5(l)(2)]

We received no comments on our proposal clarifying that disclosure of fees paid to the qualified public accountant applies only to the the qualified public accountant engaged to conduct the audit of the institution's financial statement. We finalize this change as proposed.

L. Preparing and Publishing the Quarterly Report [§ 620.10(a)]

We received no comments on our proposals to require institutions to electronically file the quarterly report with the FCA and publish the report on the institution's Web site. We also received no comments on our proposal to replace "Farm Credit bank and direct lender association" with "institution" in § 620.10. We final these changes as proposed.

M. Interim Financial Statements and Pro Forma Presentations Subsequent to Consummation of a Business Combination [§ 620.11(b)(4) and (b)(5)], and Reporting Accounting Changes and Error Corrections [§ 620.11(b)(6) and (b)(7)]

We received no comments on our proposal to remove § 620.11(b)(4) through (7) due to recent changes in accounting standards. We final these changes as proposed.

N. Independent Public Accountant [§§ 620.11(e) and 620.21(f)]

We received no comments on our proposal to replace the references to "independent public accountant" with "qualified public accountant or external auditor" in §§ 620.11(e) and 620.21(f). We final these changes as proposed.

O. Accounting for the Allowance for Loan Losses and Chargeoffs [§ 621.5(a)]

We received no comments on our proposal to revise § 621.5(a) by clarifying that a System institution's allowance for loan losses should be determined in accordance with GAAP. We final this change as proposed.

P. Reports of Condition and Performance; Applicability and General Instructions; Filing of Reports [§ 621.12(c)]

We received no comments on our proposal to require institutions to file their Call Reports electronically in accordance with the instructions prescribed by the FCA. We final this change as proposed.

Q. Technical Corrections [§ 620.5]

We received no comments on our proposal to replace the word "financing" with the word "financial". We final this change as proposed.

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby certifies that the final rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

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[1] Pub. L. 99-205, 99 Stat. 1678, Dec. 23, 1985.

[2] Pub. L. 92-181, 85 Stat. 583, Dec. 10, 1971.

List of Subjects in 12 CFR Parts 619, 620 and 621

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

For reasons stated in the preamble, parts 619, 620, and 621 of chapter VI, title 12 of the Code of Federal Regulations are amended as follows:

PART 619--DEFINITIONS

1. The authority citation for part 619 is revised to read as follows:

Authority: Secs. 1.4, 1.7, 2.1, 2.4, 2.11, 3.2, 3.21, 4.9, 5.9, 5.17, 5.18, 5.19, 7.0, 7.1, 7.6, 7.8, and 7.12 of the Farm Credit Act (12 U.S.C. 2012, 2015, 2072, 2075, 2092, 2123, 2142, 2160, 2243, 2252, 2253, 2254, 2279a, 2279a-1, 2279b, 2279c-1, 2279f).

2. Section 619.9270 is amended by revising the second sentence of paragraph (e) to read as follows:

§ 619.9270 Qualified Public Accountant or External Auditor.

* * * * *

(e) * * * For the purposes of this definition, the term "independent" has the same meaning as under the rules and interpretations of the authoritative body governing overall audit performance. * * *

PART 620--DISCLOSURE TO SHAREHOLDERS

3. The authority citation for part 620 is revised to read as follows:

Authority: Secs. 4.19, 5.9, 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2207, 2243, 2252, 2254, 2279aa-11); sec. 424 of Pub. L. 100-233, 101 Stat. 1568, 1656.

Subpart A--General

4. Section 620.3 is amended by revising paragraph (b)(3) as follows:

§ 620.3 Accuracy of reports and assessment of internal control over financial reporting.

* * * * *

(b) * * *

(3) A board member formally designated by action of the board to certify reports on behalf of individual board members.

* * * * *

Subpart B--Annual Report to Shareholders

5. Amend § 620.5 as follows:

a. Remove the word "financing" and add in its place the word "financial" each place it appears in paragraphs (e)(2), (f) heading and introductory text, (f)(1)(iii) heading, (g) heading and introductory text, (g)(1)(iv), (g)(2)(ii), (g)(2)(vi), (j)(3)(ii), and (m)(1);

b. Revise paragraphs (a)(4), (a)(10) introductory text, (g)(3)(i)(A), (h)(1), (i)(1) introductory text, and the first sentence of paragraph (l)(2);

c. Remove paragraphs (a)(10)(v), (e)(4) and (f)(2);   d. Add the word "and" at the end of paragraph (a)(10)(iii);

e. Remove "; and" and add a period at the end of paragraph (a)(10)(iv); and

f. Redesignate existing paragraphs (f)(3) and (f)(4) as newly designated paragraphs (f)(2) and (f)(3).

§ 620.5 Contents of the annual report to shareholders.

* * * * *

(a) * * *

(4) Any significant developments within the last 5 years that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends, including, but not limited to, changes in the reporting entity, changes in patronage policies and practices, and financial assistance provided by or to the institution through loss-sharing or capital preservation agreements or from any other source;

* * * * *

(10) For associations, in a separate section of the annual report, discuss the interdependent relationship between the association and its funding bank, including, but not limited to, the financial relationship, a service provider relationship, other material operational relationships, and other specific issues or areas that create a material interdependent relationship between the association and its funding bank. This separate section may incorporate by reference information from other sections of the annual report. At a minimum, the separate section must include the statement required by § 620.2(h)(2)(i) of this part and the following information required elsewhere in this section, if applicable:

* * * * *

(g) * * *

(3) * * *

(i) * * *

(A) Describe the average and yearend amounts, maturities, and interest rates on outstanding consolidated System-wide debt obligations, bond obligations, or any other obligations used to fund the institution's lending operations.

* * * * *

(h) * * *

(1) List the names of all directors and senior officers of the institution, indicating the position title and term of office of each director, and the position, title, and date each senior officer commenced employment in his or her current position.

* * * * *

(i) * * *

(1) _Director compensation._   Describe the arrangements under which directors of the institution are compensated for all services as a director (including total cash compensation and noncash compensation). Noncash compensation with an annual aggregate value of less than $5,000 does not have to be reported. State the total cash and reportable noncash compensation paid to all directors as a group during the last fiscal year. For the purposes of this paragraph, disclosure of compensation paid to and days served by directors applies to any director who served in that capacity at any time during the reporting period. If applicable, describe any exceptional circumstances justifying the additional director compensation as authorized by § 611.400(c) of this chapter. For each director, state:

* * * * *

(l) * * *

(2) Disclose the total fees, by the category of services provided, paid during the reporting period to the qualified public accountant engaged to conduct the institution's financial statement audit. * * *

* * * * *

Subpart C--Quarterly Report

6. Amend § 620.10 by revising paragraph (a) to read as follows:

§ 620.10 Preparing the quarterly report.

(a) Each institution of the Farm Credit System must:

(1) Prepare and send, to the Farm Credit Administration, an electronic copy of its quarterly report within 40 calendar days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution; and

(2) Publish a copy of its quarterly report on its Web site when it electronically sends the report to the Farm Credit Administration.

* * * * *

§ 620.11 [Amended]

7. Amend § 620.11 as follows:

a. Remove paragraphs (b)(4) through (b)(7);

b. Redesignate existing paragraph (b)(8) as newly designated paragraph (b)(4); and

c. Remove the words "independent public accountant," "an independent public accountant," and "the independent accountant" and add in their place, the words "a qualified public accountant or external auditor" in each place they appear in paragraph (e) and its heading.

Subpart E--Annual Meeting Information Statement

8. Amend § 620.21 by revising the heading and paragraph (f) to read as follows:

§ 620.21 Contents of the information statement and other information to be furnished in connection with the annual meeting or director elections.

* * * * *

(f) *Relationship with qualified public accountant or external auditor*. If an institution of the Farm Credit System has had a change or changes in its qualified public accountant or external auditor since the last annual report to shareholders, or if a disagreement with a qualified public accountant or external auditor has occurred, the institution shall disclose the information required by § 621.4(c) and (d) of this chapter.

PART 621--ACCOUNTING AND REPORTING REQUIREMENTS

9. The authority citation for part 621 continues to read as follows:

Authority: Secs. 5.17, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2279aa-11); sec. 514 of Pub. L. 102-552.

Subpart A--Purpose and Definitions

10. Amend § 621.2 by revising paragraph (d) to read as follows:

§ 621.2 Definitions.

* * * * *

(d) *Generally accepted auditing standards* means the standards and guidelines that are generally accepted in the United States of America and that are adopted by the authoritative body that governs the overall quality of audit performance.
* * * * *

Subpart B--General Rules

11. Amend § 621.5 by revising paragraph (a) to read as follows:

§ 621.5 Accounting for the allowance for loan losses and chargeoffs.
* * * * *

(a) Maintain at all times an allowance for loan losses that is determined according to generally accepted accounting principles.
* * * * *

Subpart D--Report of Condition and Performance

12. Amend § 621.12 by revising paragraph (c) as follows:

§ 621.12 Applicability and general instructions.
* * * * *

(c) All reports of condition and performance shall be submitted electronically in accordance with the instructions prescribed by the Farm Credit Administration and located on its Web site.

Date: June 12, 2009

Gaye Calhoun,
Acting Secretary,
Farm Credit Administration Board.

74 FR 29143, 06/19/2009

Handbook Mailing HM-09-5

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 617

RIN 3052-AC45

Borrower Rights; Effective Interest Rates

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA) proposes to amend two sections of its borrower rights regulations governing what initial and subsequent disclosures a qualified lender must make to a borrower when the borrower's interest rate is directly tied to a widely publicized external index. The proposed revisions would require qualified lenders to provide additional disclosure to borrowers at loan closing on how and where to track the external index, and allow qualified lenders, who are required to provide the additional disclosure, to send written notices of subsequent rate changes to borrowers no later than the borrower's first regularly scheduled billing statement after the effective date of the change.

DATES: You may send comments on or before August 18, 2009.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.

- FCA Web site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters," then "Public

Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted but, for technical reasons, we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Jacqueline R. Melvin, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA, (703) 883-4414, TTY (703) 883-4434;

or

Robert Taylor, Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objective

The objective of this proposed rule is to ensure that borrowers with loans directly tied to a widely publicized external index receive appropriate disclosure of interest rate changes in accordance with statutory requirements while minimizing regulatory burden on Farm Credit System (FCS or System) institutions.

II. What Does the Statute Require?

Section 4.13(a)(4) of the Farm Credit Act of 1971, as amended (Act), requires qualified lenders to provide borrowers, for all loans not subject to the Truth in Lending Act (15 U.S.C. 1601 et seq.), "meaningful and timely disclosure" of any change in the interest rate applicable to the borrower's loan within a "reasonable time after the effective date" of a change.[1]

III. Why did Congress Establish this Requirement?

At the time of the 1985 adoption of the interest rate notice requirements, almost all FCS loans were administered[2] rate loans and there were few, if any, FCS loans directly tied to an external index.[3] Administered rates require definitive action at the discretion of the lending bank or association to change the interest rate charged. Administered rates are usually based on an institution's internal index or other standard and take into account the lending institution's costs. Administered rates may also reflect management's assessments of whether rate changes are warranted or feasible in view of competitive market conditions; therefore, the actual interest rates charged on administered rate loans may not mirror the movement of market interest rates.[4]

Prior to adopting the interest rate notice requirements (during the farm crisis of the 1980s), Congress and FCA received a number of complaints and inquiries from borrowers about interest rate changes made on administered rate loans without adequate explanation to borrowers. Therefore, it appears that the new notice provisions were necessary to protect borrower rights because of the lack of transparency associated with the System's administered rate loans. While Congress may not have anticipated that the interest rate notice provisions cover widely publicized external index loans, these loans are not excluded from the reach of the Act.

IV. Section-by-Section Analysis

What initial disclosures must a qualified lender make to a borrower? [§ 617.7130]

The proposed revision to § 617.7130(b) would add a paragraph (6), requiring, when the borrower's interest rate is directly tied to a widely publicized external index, that a qualified lender must provide information on how and where the borrower may track changes to the index and when the borrower will receive written notice of changes to the borrower's interest rate.

This additional information would be included in the initial disclosure to ensure that borrowers have adequate knowledge, at loan closing, of how and where they may access information to monitor changes in the interest rate. Further, the borrower would be fully informed as to how billing or other statements would reflect changes in the loan's interest rate.

What subsequent disclosures must a qualified lender make to a borrower? [§ 617.7135]

Section 4.13(a)(4) of the Act requires qualified lenders to provide, no later than loan closing, notice to borrowers that change in the interest rate applicable to the borrower's loan may be made within a reasonable time after the effective date of increase or decrease. Current § 617.7135(a)(2) requires that the qualified lender provide the borrower whose loan is directly tied to a widely publicized external index a notice within 45 days after the effective date of the rate change.

We propose amending the regulation to require the qualified lender to provide written notice to the borrower of a rate change applicable to the borrower's loan no later than the borrower's first regularly scheduled billing statement after the effective date of the change, so long as the qualified lender provided the disclosures required by proposed § 617.7130(b)(6) no later than the time of loan closing.

There have been several trends in the use of external indexes and enhanced information availability that have caused us to now believe that the billing statement option is reasonable and justifiable. For example, between 1999 and 2008, the volume of administered rate loans has declined by 16 percent as more borrowers opt to use their knowledge and understanding of index loans to meet their operating needs.[5] Further, advances in technology, such as broad band Internet access in rural communities, increased usage of mobile phones and personal computers for accessing the Internet and receiving information via e-mails and text messages, provide borrowers instantaneous information regarding any changes in external index rates. Moreover, most System associations now offer borrowers online access to their loan balances, rate changes, and other information. Therefore, when a qualified lender provides the initial disclosure proposed for § 617.7130(b), we believe that written notice of subsequent rate changes to the borrower, no later than the first regularly scheduled billing statement after the effective date of the change, protects borrower rights in accordance with the statute regarding "meaningful and timely disclosure." Also, institutions do not incur the burden of additional mailing costs, which may be passed on to their borrowers.

The new notice requirements would not apply to rate changes applicable to a borrower's loan closed prior to the effective date of the final rule (the borrowers would not have received the enhanced initial disclosures). Therefore, the current 45-day notice requirement would still apply to interest rate changes on those loans.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

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[1] 12 U.S.C. 2199(a)(4). "Qualified lenders" include Farm Credit System lenders (except for a bank for cooperatives), and non-System lenders (other financing institutions (OFIs)) for loans that OFIs make with funding from a Farm Credit bank. See 12 U.S.C. 2202a(a)(6).

[2] "Administered" and "adjustable" rates are synonymous terms that describe the types of variable rates offered by System institutions.

[3] FCA considers the nationally published commercial bank Prime Rate and the London Interbank Offered Rate (LIBOR) to be the primary examples of widely publicized external indexes. Other rates may also meet the criteria, but the qualified lender must ensure that the rate is published in a source readily available to its borrowers. See 68 FR 5587 (Feb. 4, 2003).

[4] See the Federal Farm Credit Bank Funding Corporation's annual report to investors at www.farmcredit-ffcb.com.

[5] Historical data compiled from 1999 to 2008 in the Federal Farm Credit Banks Funding Corporation annual report to investors available at www.farmcredit-ffcb.com.

List of Subjects in 12 CFR Part 617

Agriculture, Banks, banking, Rural areas.

For the reasons stated in the preamble, part 617 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 617--BORROWER RIGHTS

1. The authority citation for part 617 continues to read as follows:

Authority: Secs. 4.13, 4.13A, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.36, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2199, 2200, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2219a, 2243, 2252).

Subpart B--Disclosure of Effective Interest Rates

2. Amend § 617.7130 by revising introductory text of paragraph (b) and adding a new paragraph (b)(6) to read as follows:

§ 617.7130 What initial disclosures must a qualified lender make to a borrower?

*** * * * ***

(b) *Adjustable rate loans*. A qualified lender must provide the following information for adjustable rate loans in addition to the requirements of paragraph (a) of this section:

*** * * * ***

(6) If the borrower's interest rate is directly tied to a widely publicized external index, a qualified lender must provide:

(i) How and where the borrower may track changes to the index; and

(ii) When the borrower will receive written notice of changes to the borrower's interest rate.

3. Amend § 617.7135 by revising paragraph (a)(2) to read as follows:

§ 617.7135 What subsequent disclosures must a qualified lender make to a borrower?

*** * * * ***

(a) *** * ***

(2) If the borrower's interest rate is directly tied to a widely publicized external index, a qualified lender must provide written notice to the borrower of the rate change no later than the borrower's first regularly scheduled billing statement after the effective date of the change, except that a qualified lender must provide written notice to the borrower of the rate change within 45 days after the effective date of the change if the loan closed before the disclosures required under § 617.7130(b)(6).

*** * * * ***

Dated: June 16, 2009

Roland E. Smith,
Secretary,
Farm Credit Administration Board.

74 FR 35914, 07/21/2009

Handbook Mailing HM-09-6

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket ID OCC 2009-0014]

FEDERAL RESERVE SYSTEM

[Docket No. R-1311]

FEDERAL DEPOSIT INSURANCE CORPORATION

RIN 3064-ZA00

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

[Docket ID OTS-2009-0005]

FARM CREDIT ADMINISTRATION

RIN 3052-AC46

NATIONAL CREDIT UNION ADMINISTRATION

RIN 3133-AD41

Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); Farm Credit Administration (FCA); National Credit Union Administration (NCUA).

ACTION: Notice and request for comment.

SUMMARY: The OCC, Board, FDIC, OTS, FCA, and NCUA (collectively, the Agencies) are issuing final revisions to the Interagency Questions and Answers Regarding Flood Insurance (Interagency Questions and Answers). The Agencies are also soliciting comments on proposed revisions to the Interagency Questions and Answers. To help financial institutions meet their responsibilities under Federal flood insurance legislation and to increase public understanding of the

flood insurance regulation, the Agencies are finalizing new and revised guidance, as well as proposing new and revised guidance that address the most frequently asked questions about flood insurance. The revised Interagency Questions and Answers contain staff guidance for agency personnel, financial institutions, and the public.

DATES: Effective date: September 21, 2009. Comment due date: Comments on the proposed questions and answers must be submitted on or before September 21, 2009.

ADDRESSES: OCC: Because paper mail in the Washington, DC area and at the Agencies is subject to delay, commenters are encouraged to submit comments by e-mail, if possible. Please use the title ``Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance'' to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

E-mail: regs.comments@occ.treas.gov.

Mail: Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

Fax: (202) 874-5274.

Hand Delivery/Courier: 250 E Street, SW., Attn: Communications Division, Mail Stop 2-3, Washington, DC 20219.

Instructions: You must include ``OCC'' as the agency name and ``Docket Number OCC-2009-0014'' in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice by any of the following methods:

Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC's Communications Division, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling in advance (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

Docket: You may also view or request available background documents and project summaries using the methods described above.

Board: You may submit comments, identified by Docket No. R-1311, by any of the following methods:

Agency Web Site: http://www.federalreserve.gov. Follow the instructions for

submitting comments at
http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

Federal eRulemaking Portal: http://www.Regulation.gov.

Follow the instructions for submitting comments.

E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

Fax: (202) 452-3819 or (202) 452-3102.

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

All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information.

Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN number 3064-ZA00 by any of the following methods:

Agency Web Site: http://www.fdic.gov/Regulation/laws/federal/propose.html. Follow instructions for submitting comments on the ``Agency Web Site.''

E-mail: Comments@FDIC.gov. Include the RIN number in the subject line of the message.

Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Instructions: All submissions received must include the agency name and RIN number. All comments received will be posted without change to http://www.fdic.gov/Regulation/laws/federal/propose.html including any personal information provided.

OTS: You may submit comments, identified by OTS-2009-0005, by any of the following methods:

E-mail: regs.comments@ots.treas.gov. Please include ID OTS-2009-0005 in the subject line of the message and include your name and telephone number in the message.

Fax: (202) 906-6518.

Mail: Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: OTS-2009-0005.

Hand Delivery/Courier: Guard's Desk, East Lobby Entrance, 1700 G [[Page 35915]] Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: OTS-2009-0005.

Instructions: All submissions received must include the agency name and docket number for this rulemaking. All comments received will be posted without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

Viewing Comments Electronically: OTS will post comments on the OTS Internet Site at http://www.ots.treas.gov/?p=opencomment1.

Viewing Comments On-Site: You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FCA: We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, we encourage commenters to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. You may also send comments by mail or by facsimile transmission. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

E-mail: Send us an e-mail at regcomm@fca.gov.

Agency Web Site: http://www.fca.gov. Once you are at the Web site, select ``Legal Info,'' then ``Pending Regulation and Notices.''

Federal eRulemaking Portal: http://www.Regulation.gov. Follow the instructions for submitting comments.

Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

Fax: (703) 883-4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select ``Legal

Info," and then select ``Public Comments." We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

NCUA: You may submit comments by any of the following methods (Please send comments by one method only):

Federal eRulemaking Portal: http://www.Regulation.gov. Follow the instructions for submitting comments.

NCUA Web Site: http://www.ncua.gov/RegulationOpinionsLaws/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.

E-mail: Address to regcomments@ncua.gov. Include ``[Your name] Comments on Flood Insurance, Interagency Questions & Answers" in the e-mail subject line.

Fax: (703) 518-6319. Use the subject line described above for e-mail.

Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

Hand Delivery/Courier: Same as mail address.

Public Inspection: All public comments are available on the agency's Web site at http://www.ncua.gov/RegulationOpinionsLaws/comments as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT:

OCC: Pamela Mount, National Bank Examiner, Compliance Policy, (202) 874-4428; or Margaret Hesse, Special Counsel, Community and Consumer Law Division, (202) 874-5750, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Vivian Wong, Senior Attorney, Division of Consumer and Community Affairs, (202) 452-2412; Tracy Anderson, Senior Supervisory Consumer Financial Services Analyst (202) 736-1921; or Brad Fleetwood, Senior Counsel, Legal Division, (202) 452-3721, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW.,
Washington, DC 20551. For the deaf, hard of hearing, and speech impaired only, teletypewriter (TTY), (202) 263-4869.

FDIC: Mira N. Marshall, Chief, Compliance Policy Section, Division of Supervision and Consumer Protection, (202) 898-3912; or Mark Mellon, Counsel, Legal Division, (202) 898-3884, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429. For the hearing impaired only, telecommunications device for the deaf TDD: 800-925-4618.

OTS: Ekita Mitchell, Consumer Regulation Analyst, (202) 906-6451; or Richard S. Bennett, Senior Compliance Counsel, (202) 906-7409, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

FCA: Mark L. Johansen, Senior Policy Analyst, Office of Regulatory Policy, (703) 993-4498; or Mary Alice Donner, Attorney Advisor, Office of General Counsel, (703) 883-4033, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090. For the hearing impaired only, TDD (703) 883-4444.

NCUA: Justin M. Anderson, Staff Attorney, Office of General Counsel, (703) 518-6540; or Pamela Yu, Staff Attorney, Office of General Counsel, (703) 518-6593, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

SUPPLEMENTARY INFORMATION:

Background

The National Flood Insurance Reform Act of 1994 (the Reform Act) (Title V of the Riegle Community Development and Regulatory Improvement Act of 1994) comprehensively revised the two Federal flood insurance statutes, the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973. The Reform Act required the OCC, Board, FDIC, OTS, and NCUA to revise their flood insurance regulations and required the FCA to promulgate a flood insurance regulation for the first time. The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, ``the Agencies'') fulfilled these requirements by issuing a joint final rule in the summer of 1996. See 61 FR 45684 (August 29, 1996).

In connection with the 1996 joint rulemaking process, the Agencies received a number of requests to clarify specific issues covering a wide spectrum of the proposed rule's provisions. The Agencies addressed many of these requests in the preamble to the joint final rule. The Agencies concluded, however, that given the [[Page 35916]] number, level of detail, and diversity of the requests, guidance addressing the technical compliance issues would be helpful and appropriate. Consequently, the Agencies decided to issue guidance to address these technical issues subsequent to the promulgation of the final rule (61 FR at 45685-86). The Federal Financial Institutions Examination Council (FFIEC) fulfilled that objective through the initial release of the Interagency Questions and Answers in 1997 (1997 Interagency Questions and Answers). 62 FR 39523 (July 23, 1997).

In response to issues that had been raised, the Agencies, in coordination with the Federal Emergency Management Agency (FEMA), released for public comment proposed revisions to the 1997 Interagency Questions and Answers. 73 FR 15259 (March 21, 2008) (March 2008 Proposed Interagency Questions and Answers). Among the changes the Agencies proposed were the introduction of new questions and answers in a number of areas, including second lien mortgages, the imposition of civil money penalties, and loan syndications/participations. The Agencies also proposed substantive modifications to questions and answers previously adopted in the 1997 Interagency Questions and Answers pertaining to construction loans and condominiums. Finally, the Agencies proposed to revise and reorganize certain of the existing questions and answers to clarify areas of potential misunderstanding and to provide clearer guidance to users.

The Agencies received and considered comments from 59 public commenters, and are now adopting the Interagency Questions and Answers, comprising 77 questions and answers, revised as appropriate based on comments received. The Agencies made nonsubstantive revisions to certain answers upon further consideration either to more directly respond to the question asked or to provide additional clarity. The Agencies are also proposing five new questions and answers for public comment. These Interagency Questions and Answers supersede the 1997 Interagency Questions and Answers and supplement other guidance or interpretations issued by the Agencies and FEMA.

For ease of reference, the following terms are used throughout this document: ``Act'' refers to 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 (codified at 42 U.S.C. 4001 et seq.). ``Regulation'' refers to each agency's current final flood insurance rule.\1\

\1\ The Agencies' rules are codified at 12 CFR part 22 (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (FDIC), 12 CFR part 572 (OTS), 12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA).

Section-by-Section Analysis

Section I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance Is Required Under the Act and Regulation

The Agencies proposed this new section to address specific circumstances a lender may encounter when deciding whether a loan should be a designated loan for purposes of flood insurance. The proposed new section was intended to replace the previous section I in the 1997 Interagency Questions and Answers entitled ``Definitions'' and to incorporate existing questions from other sections addressing this topic and two new questions.

Proposed question and answer 1 addressed the applicability of the Regulation to loans made in a nonparticipating community. One commenter suggested the Agencies mention that a lender may choose to require private flood insurance per its loan agreement with the borrower, for buildings or mobile homes located outside a community in the National Flood Insurance Program (NFIP). The Agencies agree that lenders have such discretion, but do not believe that the question and answer requires further elaboration. Another commenter suggested the Agencies mention that Government Sponsored Enterprises (GSEs), such as Fannie Mae and Freddie Mac, may not purchase loans made on properties in a Special Flood Hazard Area (SFHA) in communities that do not participate in the NFIP. The Act does require GSEs to have procedures in place to ensure that purchased loans are in compliance with the mandatory purchase requirements. The

Agencies do not believe that further elaboration is necessary and adopt the question and answer as proposed.

Proposed question and answer 2 explained that, upon a FEMA map change that results in a building or mobile home securing a loan being removed from an SFHA, a lender is no longer obligated to require mandatory flood insurance. However, the lender may choose to continue to require flood insurance for risk management purposes. The Agencies received one comment from an industry group suggesting the guidance in proposed question and answer 2 be amended to add language encouraging lenders to promptly remove the flood insurance requirement from a loan when the building or mobile home securing the loan is removed from an SFHA by way of a map change. The decision to require flood insurance in these instances is typically made on a case-by-case basis, depending on a lender's risk management practices. The Agencies do not believe that a blanket statement encouraging lenders to remove flood insurance in such instances is an appropriate position; therefore, the question and answer is adopted as proposed.

Proposed question and answer 3 addressed whether a lender's purchase of a loan, secured by a mobile home or building located in an SFHA in which flood insurance is available under the Act, from another lender triggers any requirements under the Regulation. The Agencies received several comments opposing the reference to safety and soundness necessitating a due diligence review prior to purchasing the loan. The Agencies note that although lenders are not required to review loans for flood insurance compliance prior to purchase, depending upon the circumstances, safety and soundness considerations may sometimes necessitate such due diligence. As such, the Agencies do not concur with the commenter's opposition and adopt question and answer 3 as proposed.

The Agencies are adopting a new question and answer 4 addressing syndicated and participation loans following question and answer 3, which deals with purchased loans, to emphasize the need for similar treatment of purchased loans and syndicated and participation loans. The new question and answer was initially proposed as question and answer 40 under section VIII. Proposed section VIII on loan syndications and participations and the accompanying question and answer are removed and the remaining sections are renumbered accordingly.

Proposed question and answer 40 explained that, with respect to loan syndications and participations, individual participating lenders are responsible for ensuring compliance with flood insurance requirements. The proposed answer further explained that participating lenders may fulfill this obligation by performing upfront due diligence to ensure that the lead lender or agent has undertaken the necessary activities to make sure that appropriate flood insurance is obtained and has adequate controls to monitor the loan(s) on an on-going basis.

The Agencies received several comments from financial institutions and industry trade groups opposing the [[Page 35917]] differences between the guidance in proposed question and answer 3 regarding the purchase of a loan and the guidance in proposed question and answer 40. A majority of the commenters argued that loan participations and syndications should be treated the same as other loan purchases for purposes of flood insurance. Several of these commenters suggested that the Agencies' proposed treatment of loan syndications and participations appeared to be inconsistent with proposed question and answer 3 pertaining to purchased loans.

In response to these comments, the Agencies are revising the relevant question and answer to reflect that, as with purchased loans, the acquisition by a lender of an interest in a loan either by participation or syndication, after that loan has been made, does not trigger the requirements of the Act and Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. Nonetheless, as with purchased loans, depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake due diligence to protect itself against the risk of flood or other types of loss.

If a regulated lender is involved in the making of the underlying loan, but does not purchase a loan participation or syndication after the loan has been made, the flood requirements of the Act and Regulation would apply to the lender. The Agencies believe that lenders who pool or contribute funds that will be advanced simultaneously to a borrower as a loan secured by improved real estate would all be considered to have ``made'' the loan under the Act and Regulation. In such circumstances, each participating lender in a loan participation or syndication is responsible for compliance with the Act and Regulation. This does not mean that each participating lender must separately obtain a flood determination or monitor whether flood insurance premiums are paid. Rather, it means that each participating lender subject to Federal flood insurance requirements should perform upfront due diligence to ensure both that the lead lender or agent has undertaken the necessary activities to make sure 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. The participating lender should require as a condition to the loan-sharing agreement that the lead lender or agent will provide participating lenders with sufficient information on an ongoing basis to monitor compliance with flood insurance requirements. A written representation provided by the lead lender or syndication agent certifying that the borrower has obtained appropriate flood insurance would be sufficient. Alternatively, the lead lender or syndication agent could provide participants and syndication lenders with a copy of the declaration page or other proof of insurance. The Agencies have incorporated minor revisions to the question and answer to clarify this guidance.

Proposed question and answer 4 (final question and answer 5) addressed the applicability of the Regulation to loans being restructured because of the borrower's default on the original loan. In light of the many loan modifications being made, the Agencies have revised the question to address loan modifications as well as loans being restructured because of the borrower's default on the original loan. The guidance provided in the answer is applicable to either situation. The Agencies received one comment asking whether capitalization of a loan in the event of a default would constitute an increase in the loan, triggering the requirements of the Regulation. If the capitalization results in an increase in the outstanding principal balance of the loan, then the requirements of the Regulation will apply. Conversely, a loan restructure that does not result in an increase in the amount to the loan (or an extension of the term of the loan) will not trigger the requirements of the Regulation. The Agencies do not believe further elaboration addressing this comment is necessary. The Agencies adopt the question and answer as proposed with the changes made to include loan modifications, as well as restructuring of loans.

Proposed question and answer 5 (final question and answer 6), addressed whether table funded loans are treated as new loan originations. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 6 (final question and answer 7) explained that a lender is not required to perform a review of its existing loan portfolio for purposes of the Act or Regulation; however,
sound risk management practices may lead a lender to conduct periodic reviews. The Agencies received several comments opposing the reference to safety and soundness necessitating a due diligence review of a lender's portfolio. Although lenders are not required to review existing loan portfolios for flood insurance compliance under the Act or Regulation, the Agencies believe safety and soundness considerations may sometimes necessitate such due diligence and therefore adopt the question and answer as proposed.

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

The Agencies proposed this section to provide guidance on how lenders should determine the appropriate amount of flood insurance to require the borrower to purchase. The Agencies received numerous comments on this proposed section. As a result of these comments, the Agencies have made both significant revisions to proposed questions and answers as well as proposed new questions and answers submitted for comment to provide greater clarity on this important area. The proposed new questions and answers are addressed in the SUPPLEMENTARY INFORMATION immediately following the Redesignation Table.

Proposed question and answer 7 (final question and answer 8) addressed what is meant by the ``maximum limit of coverage available for the particular type of property under the Act.'' The first part of the question and answer discussed the maximum caps on insurance available under the Act. The Agencies did not receive any substantive comments on this part of the question and answer and adopt it as proposed in final question and answer 8. The second part of the question and answer discussed the maximum limits on the coverage in the context of the regulation that provides that ``flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located,'' commonly referred to as insurable value. In response to the numerous comments received on the insurable value part of the proposed question and answer, the Agencies are proposing new questions and answers 9 and 10 for public comment. The Agencies otherwise adopt question and answer 7 (final question and answer 8) as proposed.

Proposed questions and answers 8 and 9 (final questions and answers 11 and 12 respectively) more fully defined the terms ``residential building'' and ``nonresidential building.'' One commenter suggested that the Agencies define residential and nonresidential buildings based on the percentage of the building used in a certain way to account for mixed use buildings. [[Page 35918]]
Proposed question and answer 8 (final question and answer 11) provides that a residential building may have incidental nonresidential use as long as such incidental use is limited

to less than 25 percent of the square footage of the building. A mixed use residential building where greater than 25 percent of the square footage of the building is devoted to incidental nonresidential use will be considered a nonresidential building. Proposed question and answer 9 (final question and answer 12) provides that a mixed use nonresidential building with less than 75 percent of the square footage of the building used for residential purposes will still be considered nonresidential. The commenter also asked whether a farm house is residential or nonresidential. If the farmhouse is used as a dwelling, then it will be considered residential.

Another commenter asked whether a lender is obligated to determine the amount of nonresidential use in a residential building and whether there are any record maintenance requirements. Typically, whether a building is nonresidential or residential is of most importance in determining the maximum limits of a general property form NFIP policy. A residential building covered under a general property form will have a maximum coverage limit of $250,000, while a nonresidential building covered under the same type of policy will have a maximum coverage limit of $500,000. Therefore, the lender needs to know whether the building is considered residential or nonresidential when it determines the amount of flood insurance coverage to require. Finally, a commenter asked whether a designated loan, secured by a residential building and a detached nonresidential building, such as a garage, would require separate nonresidential coverage on the detached nonresidential building. If the residential building is a one-to-four family dwelling that is covered by a dwelling form NFIP policy, that policy will cover a detached garage at the same location as the dwelling, up to 10 percent of the limit of liability on the dwelling, so long as the detached garage is not used or held for use as a residence, a business or for farming purposes. In other cases, the lender must require the borrower to obtain coverage for each building securing the loan. The Agencies believe no further clarification is necessary and adopt the questions and answers as proposed.

Proposed question and answer 10 (final question and answer 13) illustrated how to apply the ``maximum limit of coverage available for the particular type of building under the Act.'' The majority of the comments received are addressed in the discussion below pertaining to new proposed questions and answers 9 and 10. The Agencies adopt question and answer 10 (final question and answer 13) as proposed.

Proposed questions and answers 11 and 12 (final questions and answers 14 and 15 respectively) were originally adopted in the 1997 Interagency Questions and Answers. The changes proposed by the Agencies in March 2008 were designed to provide greater clarity with no intended change in substance and meaning.

Four commenters addressed proposed question and answer 11, which dealt with flood insurance requirements where a designated loan is secured by more than one building. One commenter supported the proposed question and answer, but suggested that where the collateral is worthless and would not be replaced, lenders should not have to require the borrower to obtain flood insurance. The Agencies are proposing questions 9 and 10 for public comment to address the issue of determining insurable value for certain nonresidential buildings that include certain low-value nonresidential buildings. Another commenter asked whether a lender would be liable if the lender allocates the overall required flood insurance over several buildings and one building suffers flood damage and is underinsured. In such a circumstance, the lender would have complied with the Act and the Regulation. Of course, the lender has the option to require the borrower to obtain more flood insurance coverage than the minimum amount required if the lender believes there is a high risk of flood loss (see final question and answer 16). Two commenters suggested that the Agencies should explain how the lender should allocate the required amount of coverage for multiple buildings of different values that secure a single loan. One of these commenters suggested that allocation could be made by a square footage method. The Agencies agree that this is one reasonable method that could be used. Other methods may include a value-based method, splitting the total coverage pro rata based on replacement cost value, or a functionality method, requiring a higher proportional share of coverage to those buildings that are most important to the ongoing operation of the borrower. The apportionment of the required coverage in any particular situation should reflect consideration by both the lender and borrower of their needs and risks. The Agencies believe no further clarification is necessary but revised the answer to address the technical issue that single-family dwellings are considered residential if less than 50 percent of the square footage is used for an incidental nonresidential purpose.

Twenty commenters addressed proposed question and answer 12, which addressed the flood insurance requirements where the insurable value of a building securing a designated loan is less than the outstanding principal balance of the loan. The comments generally raised concerns about the lack of a definition of ``insurable value,'' discussed above in connection with proposed question and answer 7. As previously mentioned, the Agencies are proposing new questions and answers 9 and 10 for public comment to address the issue of insurable value. One commenter also asked whether the Agencies will require a lender to review flood insurance policies annually at renewal and increase coverage as the replacement cost value increases. The Agencies typically will not require such a review. However, if at any time during the term of the loan, the lender determines that flood insurance coverage is insufficient, the lender must comply with the force placement procedures in the Regulation. The Agencies believe no further clarification is necessary and adopt the question and answer as proposed.

Proposed question and answer 13 (final question and answer 16) clarified that a lender can require more flood insurance than the minimum required by the Regulation. The Regulation requires a minimum amount of flood insurance; however, lenders may require more coverage, if appropriate. Two commenters asked the Agencies to specify that lenders may never require coverage that exceeds the insurable value of a building. As stated in the question and answer, lenders should avoid creating situations where a building is over-insured. Further, the Agencies state in final question and answer 8 that ``an NFIP policy will not cover an amount exceeding the insurable value of the structure.'' Another commenter asked what penalties, if any, would be imposed on a lender that requires over insurance. The Agencies note that there are no penalties for over insurance under the Act and Regulation. However, there may be penalties for over-insurance under applicable State law. Finally, a commenter suggested that flood insurance should not be required where the collateral building is worthless and would not be replaced. The Agencies are proposing questions 9 and 10 for public comment to address the issue of [[Page 35919]] determining insurable value for certain nonresidential buildings that include certain low value nonresidential buildings. Other than a nonsubstantive revision to provide additional clarity, the Agencies adopt the question and answer as proposed.

Proposed question and answer 14 (final question and answer 17) addressed lender considerations regarding the amount of the deductible on a flood insurance policy

purchased by a borrower. Generally, the proposed guidance advised a lender to determine the reasonableness of the deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and lender. The Agencies received nine comments addressing proposed question and answer 14. Four commenters suggested that borrowers with low-value buildings should be able to choose a deductible that exceeds the value of the building with a result that flood insurance would not be required. The Act and Regulation require flood insurance on all buildings at the lesser of the outstanding principal balance of the loan or the maximum amount available under the Act. A high deductible does not provide a de facto waiver of this requirement. One commenter suggested that the
Agencies' position regarding not allowing a de facto waiver of the flood insurance requirement on low-value buildings based on the deductible amount contradicts the NFIP's policy of following the
standard practice in the financial industry of allowing lenders to dictate the amount of the deductible according to the authority found in the loan agreement. Other commenters stated that a lender should not be required to determine deductibles on a case-by-case basis but rather through adoption of credit guidelines that apply across-the-board to all loans. In general, the Agencies agree that lenders may adopt credit guidelines that apply to most loans. However, such guidelines cannot work to waive the flood insurance requirements of the Act and Regulation. Finally, one commenter suggested that the Agencies should mention that the GSEs may have maximum allowable deductibles. The Agencies decline to revise the question and answer based on this comment because information about GSE requirements is outside the scope of this guidance. The Agencies adopt the question and answer as proposed.

Section III. Exemptions From the Mandatory Flood Insurance Requirements

This section contains only one question and answer, which describes the statutory exemptions from the mandatory flood insurance requirements. Proposed question and answer 15 (final question and
answer 18) was revised from the 1997 Interagency Questions and Answers to provide greater clarity, with no intended change in substance or meaning. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Section IV. Flood Insurance Requirements for Construction Loans

The Agencies proposed this new section to clarify the requirements regarding the mandatory purchase of flood insurance for construction loans to erect buildings that will be located in an SFHA in light of concerns raised by some regulated lenders regarding borrowers' difficulties in obtaining flood insurance for construction loans at the time of loan origination. The Agencies received a number of comments on the proposed questions and answers concerning construction loans. Several commenters asked for guidance in determining the appropriate amount of flood insurance for a loan secured by a building during the course of construction. This guidance is provided in the discussion of the proposed new questions and answers 9 and 10 for public comment that addresses insurable value.

Proposed question and answer 16 (final question and answer 19) revises existing guidance to limit its scope and explained that a loan secured only by land located in an SFHA is not a designated loan that would require flood insurance coverage. The Agencies received one comment addressing this question and answer from a financial institution commenter that asked whether a loan secured by developed land without a structure on it, which, during the course of the loan, will not have any structure on it, necessitates a flood determination as it is considered residential real estate. The Agencies believe that the commenter has raised a valid point and have revised the proposed question and answer by removing the reference to ``raw'' land. The revised question and answer discusses loans secured only by ``land.'' Since a designated loan is a loan secured by a building or mobile home that is located or to be located in an SFHA, any loan secured only by land that is located in an SFHA is not a designated loan since it is not secured by a building or mobile home. In the case of this particular comment, the loan is not secured by either a building or mobile home; therefore, it is not a designated loan. The Agencies adopt the question and answer as proposed with the modification described above.

Proposed question and answer 17 (final question and answer 20) addressed whether a loan secured or to be secured by a building in the course of construction that is located or to be located in an SFHA in which flood insurance is available under the Act is a designated loan. The proposed answer provided that a lender must make a flood determination prior to loan origination for a construction loan. If the flood determination shows that the building securing the loan will be located in an SFHA, the lender must provide notice to the borrower, and must comply with the mandatory purchase requirements.

One financial institution commenter asked whether the lender/servicer must provide continuing flood insurance coverage where a structure in an SFHA covered by flood insurance is considered a total loss/demolished and only the land remains and the structure is to be rebuilt. The Agencies believe that if there is remaining insurable value in the building, flood insurance should continue to be maintained. If the building has no remaining insurable value, then flood insurance is not required. Under these circumstances, the total loss situation is akin to a loan secured only by land located in an SFHA, which is addressed in final question and answer 19 discussed above, and is not a designated loan that would require flood insurance coverage. If the building is a total loss/demolished and has no remaining insurable value, but a new structure is going to be built in its place, it should be treated like a new construction loan as discussed below in proposed question and answer 19 (final question and answer 22). To the extent that any new structure that will be built is, or will be, located in an SFHA, then the lender must provide notice to the borrower, and must comply with the mandatory purchase requirements as outlined in proposed questions and answers 18 and 19 (final questions and answers 21 and 22). The lender can, of course, elect to maintain the flood insurance that had previously been in place on the prior demolished structure to avoid having to monitor the reconstruction as discussed below.

Another financial institution commenter asked whether a building in the course of construction that will be a condominium building when finished can be insured under a Residential Building Condominium Association Policy (RCBAP) during the construction period. The RCBAP can be sold to a condominium association only. Therefore, unless the building is under [[Page 35920]] the condominium form of ownership with a condominium association formed at the time of construction, no RCBAP can be written. If there is no condominium association, the lender should require the builder/developer to obtain flood insurance under the NFIP General Property form or private equivalent. If the building will be a residential condominium, then the lender must require flood insurance to meet the statutory requirements, up to the $250,000 flood insurance limit under the NFIP for an ``other residential'' building.

Finally, a loan servicer commenter asked the Agencies to clarify when flood insurance coverage takes effect when a lender opts to require flood insurance at origination of a construction loan. This
comment is addressed in final question and answer 21. The Agencies adopt the final question and answer 20 as proposed.

Proposed question and answer 18 (final question and answer 21) explained that, generally, a building in the course of construction is eligible for coverage under an NFIP policy, and that coverage may be purchased prior to the start of construction. One financial institution commenter asked whether the definition of a ``building'' in the proposed question and answer has the same meaning as FEMA's definition in its Mandatory Purchase of Flood Insurance Guidelines.\2\ The Agencies believe that the definitions of ``building,'' as well as the definition of ``building in the course of construction,'' used by FEMA are fully consistent with the definition in the Regulation. The Agencies adopt the question and answer as proposed with only minor clarifications to the citation of FEMA's Flood Insurance Manual.

\2\ FEMA, Mandatory Purchase of Flood Insurance Guidelines (September 2007) at GLS--1-2. FEMA has made this booklet available electronically at tp://www.fema.gov/library/viewRecord.do?id=2954. Hard copies are available by calling FEMA's Publication Warehouse at (800) 480-2520.

Proposed question and answer 19 (final question and answer 22), addressed when flood insurance must be purchased for buildings under the course of construction. The answer provided lenders with flexibility regarding the timing of the mandatory purchase requirement for construction loans in response to concerns raised by lenders that borrowers have encountered difficulties in obtaining flood insurance for construction loans at the time of origination. Specifically, the Agencies proposed to permit lenders to allow borrowers to defer the purchase of flood insurance until a foundation slab has been poured and/or an elevation certificate has been issued. Lenders choosing this option, however, must require the borrower to have flood insurance in place before funds are disbursed to pay for building construction on the property securing the loan (except as necessary to pour the slab or perform preliminary site work). A lender who elects this approach and does not require flood insurance at loan origination must have adequate internal controls in place to ensure compliance. Moreover, lenders must still ensure that the required flood determination is completed at origination and that notice is given to borrowers if the property is located in an SFHA.

A financial institution and a financial institution membership organization commented that requiring lenders to have monitoring procedures in place to ensure that the borrower obtains flood insurance
as soon as the foundation is complete or the elevation certificate issued is too

burdensome. The Agencies note that if a lender determines that this option is too burdensome they may continue the practice of requiring flood insurance at origination. The monitoring procedures are only necessary in the event that lenders choose to require flood insurance at the time the foundation pad is completed and/or the elevation certificate is obtained. Therefore, the Agencies believe that no revision to the proposed question and answer is necessary.

Several commenters, including four financial institutions and a law firm that advises financial institutions, asked the Agencies for clarification regarding the ``timing'' options available for
determining whether flood insurance is required for buildings in the course of construction, that is, the foundation alone and/or the issuance of an elevation certificate. Either the pouring of the
foundation slab or the issuance of an elevation certificate provides sufficient information for a lender to determine whether the collateral building is located in an SFHA for which flood insurance is required. The Agencies believe that no further elaboration is necessary to address this issue in the question and answer.

Finally, one individual commenter indicated that it is unclear whether an NFIP policy can be purchased before two walls and a roof have been erected. FEMA guidance provides that buildings yet to be walled and roofed are generally eligible for coverage after an elevation certificate is obtained or a foundation slab is poured, except where either construction is halted for more than 90 days or if
the lowest floor used for rating purposes is below Base Flood Elevation (BFE). If the lowest floor is under BFE, then the building must be walled and roofed before flood insurance coverage is available.\3\ The Agencies believe that the commenter has raised a valid point and have clarified the proposed question and answer accordingly. The Agencies otherwise adopt the question and answer as proposed.

\3\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 30-31.

The Agencies also proposed new question and answer 20 (final question and answer 23) to clarify whether the 30-day waiting period for an NFIP policy applies when the purchase of flood insurance is deferred in connection with a construction loan since there has been confusion among lenders on this issue in the past. Per guidance from FEMA, the answer provided that the 30-day waiting period would not apply in such cases.\4\ The NFIP would rely on the insurance agent's representation that the exception applies unless a loss has occurred during the first 30 days of the policy period. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

\4\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 30.

Section V. Flood Insurance Requirements for Nonresidential Buildings

The Agencies proposed this new section to address the flood insurance requirements for agricultural buildings that are taken as security for a loan, but that have limited utility

to a farming
operation, and loans secured by multiple buildings where some are located in an SFHA and others are not. Six commenters suggested that this section should be broadened to include all nonresidential
buildings, including multiple nonresidential buildings over a large geographic area, not just those related to agriculture. The Agencies concur and have changed the title to section V to read ``Flood
Insurance Requirements for Nonresidential Buildings'' and modified proposed questions and answers 21 and 22 (final question and answers 24 and 25) accordingly. Several commenters asked for guidance in determining the appropriate amount of flood insurance for loans secured by a nonresidential building, particularly for nonresidential buildings of low to no value. The Agencies are proposing questions 9 and 10 for public comment to address the issue of determining insurable value for certain nonresidential buildings that include certain low value nonresidential buildings.

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Proposed question and answer 21 (final question and answer 24) explained that all buildings taken as security for a loan and located in an SFHA require flood insurance. The question and answer also explained that lenders may consider ``carving out'' a building from the security for a loan; however, it may be inappropriate for credit risk management reasons to do so. One commenter questioned whether lenders need to require flood insurance when the collateral is only a building (in the commenter's case, a grain bin) and not the real property where the building is located. Further, the commenter stated that they only use a UCC fixture filing to secure the building. Flood insurance is required for any building taken as collateral when that building is located in an SFHA in a participating community. This requirement is not predicated on whether the underlying real estate is also included in the loan collateral or the method used by the lender to secure its collateral. FEMA answered the question of whether a grain bin is a building by specifically including a grain bin in its definition of a nonresidential building, therefore flood insurance is required.\5\

\5\ FEMA, Flood Insurance Manual, GR 2.

A commenter stated that if the value of a building is worthless or nearly zero then flood insurance should not be required. The Act requires all buildings located in an SFHA and in a participating
community to have flood insurance with only two exemptions--when a building is State-owned and covered by self-insurance satisfactory to the Director of FEMA; and when the original loan balance is $5,000 or less and the original repayment term is one year or less. All other buildings are required to be covered by flood insurance. The Agencies are proposing questions 9 and 10 for public comment to address the issue of determining insurable value for certain nonresidential buildings that include certain low value nonresidential buildings.

Another commenter suggested that in determining ``insurable value,'' institutions should be permitted to place good faith reliance on insurance agents who are better equipped to make these determinations. Federally regulated lenders may solicit assistance when evaluating insurable value and this assistance could include an insurance professional. However, it is ultimately the lender's responsibility to determine the insurable value of a building and, as such, it must concur with the determination. The same commenter also asked the Agencies to explain the rationale for treating hazard insurance and flood insurance differently. The reason for treating flood insurance and hazard insurance differently is that flood insurance includes coverage for the repair or replacement cost of the foundation and supporting structures whereas hazard insurance typically does not include coverage of the foundation. Therefore, the calculation of insurable value for flood insurance includes these repair or replacement costs while the calculation of insurable value for hazard insurance does not.

Lastly, a commenter suggested that the Agencies include additional questions and answers about other problems that arise between lenders and insurance companies, such as insurance companies requiring higher amounts of coverage than the appraised value of a structure of minimal value. The amount of flood insurance required by the Act is the lesser of the outstanding principal balance of the loan, the maximum allowed under the Act, or the insurable value. The appraised market value of the structure is not a factor in determining the amount of required insurance. The Agencies adopt question and answer 21 with the changes made to include all nonresidential buildings and not just agricultural buildings.

Proposed question and answer 22 (final question and answer 25) addressed the flood insurance requirements for multiple agricultural buildings located throughout a large geographic area, some in an SFHA and some not. One commenter suggested that the Agencies modify the first sentence in the proposed answer to refer to ``improved property'' rather than ``property.'' The Agencies concur with this recommendation and have inserted ``improved real estate'' in the place of the term ``property'' throughout the answer. The term ``improved real estate,'' instead of the suggested ``improved property,'' was added because it is the term used in the Act.

A commenter asked the Agencies to address the situation where an insurance company requires flood insurance on all buildings on the property, not just those inside an SFHA and another commenter asked the Agencies to mention that a lender can require flood insurance on buildings not located in an SFHA. The Act does not prohibit a lender from requiring more flood insurance than the minimum required by the Act; a lender may have legitimate business reasons for requiring more flood insurance than that required by the Act and neither the Act nor the Regulation prohibits this additional flood insurance. Finally, a commenter suggested that the Agencies modify the second to last sentence in the answer to refer to ``improved property securing the loan'' rather than ``designated loan.'' The Agencies have deleted this sentence entirely as it is not needed to answer the question. The Agencies adopt the question and answer with the modifications discussed above.

Section VI. Flood Insurance Requirements for Residential Condominiums

The Agencies proposed this new section to address flood insurance requirements for residential condominiums. The proposed section contained two previously existing questions and answers, which were modified and expanded, and five new questions and answers. The Agencies received numerous comments addressing this section.

A number of commenters addressed the 2007 FEMA requirement that insurance companies providing a Residential Building Association Policy (RCBAP) include the replacement cost value of the condominium building and the number of units in the building on the declaration page.\6\ Two commenters suggested that the Agencies should enforce this requirement over all insurance companies. The Agencies strongly support this FEMA requirement; however, the Agencies may only enforce the requirement against those entities over which the Agencies have jurisdiction.

\6\ FEMA Memorandum for Write Your Own (WYO) Principal Coordinators and NFIP Servicing Agent (Apr. 18, 2004) (subject: Oct. 1, 2007 Program changes).

Proposed question and answer 23 (final question and answer 26) explained that residential condominiums were subject to the statutory and regulatory requirements for flood insurance. The Agencies received only one comment addressing this question and answer, which was in agreement with the guidance. The Agencies adopt the question and answer as proposed.

One commenter suggested that an RCBAP should be described in a separate question and answer in this section. Although the RCBAP was described within the proposed questions and answers, the Agencies have compiled the information from proposed questions and answers 24 and 25 into new question and answer 27 to specifically describe an RCBAP, and renumbered the remaining questions and answers accordingly.

Proposed question and answer 24 (final question and answer 28) [[Page 35922]] discussed the amount of flood insurance that a lender must require with respect to residential condominium units to comply with the mandatory purchase requirements under the Act and the Regulation. The Agencies received a number of comments addressing various aspects of this question and answer.

Several commenters suggested that lenders should be able to rely on the replacement cost value and number of units provided on the declaration page of the RCBAP in determining the insurable value of a condominium unit. The Agencies generally agree that a lender may rely on the replacement cost value and number of units provided on the declaration page unless it has reason to believe that such amounts conflict with other available information. If there is a conflict, the lender should notify the borrower of the facts that cause the lender to believe there is a conflict. If the lender believes that the borrower is underinsured, it should require the purchase of a Dwelling Policy for supplemental coverage. The Agencies have modified the question and answer accordingly.

Several commenters asked about other types of valuation information that may be appropriate to use in determining the insurable value of a condominium unit when the insurance provider does not include the replacement cost value and number of units on the RCBAP's declaration page. While the Agencies believe that the question and answer does not require further elaboration on this point, the Agencies note that consistent with safe and sound lending practices, lenders should maintain information about the value of their collateral. Even if the insurance provider does not include the replacement cost value of the condominium building and the total number of units on the declaration page, lenders typically have other sources of valuation information, including cost-approach appraisals, automated valuation systems, and tax assessments. Further, many lenders' policies and procedures include obtaining specific documentation related to condominium collateral that may provide information about the condominium's insurable value, including copies of condominium master insurance policies or the declaration pages of such policies. The Agencies generally will not criticize a lender that, in good faith, has used a reasonable method to determine the insurable value.

Several commenters agreed that RCBAP coverage written at replacement cost value, assuming that value is less than the outstanding principal amount of the loan or the maximum available under the Act, is the appropriate insurable value for a condominium building and that an RCBAP with that coverage would meet the mandatory purchase requirement for an individual unit borrower. The 1997 Interagency Questions and Answers stated that RCBAP coverage of 80 percent of replacement cost value was sufficient to meet the mandatory purchase requirement. Because of this change in policy, commenters urged the Agencies to ensure that the new guidance will apply only prospectively. Consistent with the stated intention in the March 2008 Proposed Interagency Questions and Answers, the Agencies intend that this guidance will apply to any loan that is made, increased, extended, or renewed on or after the effective date of these Interagency Questions and Answers.

The Agencies had previously indicated in the SUPPLEMENTARY INFORMATION to the March 2008 Proposed Interagency Questions and Answers that the new guidance would apply to a loan made prior to the effective date of this guidance, but only as of the first flood insurance policy renewal following the effective date of the guidance. Three commenters asked the Agencies to reconsider this position. The commenters asserted that lenders making loans secured by individual condominium units generally do not receive RCBAP renewal notifications from the insurance providers; therefore, the lender may not be in a position to make a determination at the first RCBAP renewal period following the effective date of this guidance.

Lenders are required to ensure that designated loans are covered by flood insurance for their term. However, the Agencies recognize that lenders made loans and required coverage amounts in reliance on the previous guidance. Therefore, the Agencies have agreed that the revised guidance will not apply to any loan made prior to the effective date of this guidance unless a trigger event occurs in connection with the loan (that is, the loan is refinanced, extended, increased, or renewed). Because the Agencies provided supervisory guidance that stated that an RCBAP with coverage at 80 percent of replacement cost value was sufficient, any loan for a condominium unit relying on an RCBAP with coverage that complied with that guidance was in compliance at the time it was made. Absent a new trigger event, the Agencies, therefore, will not require lenders to ensure that RCBAP coverage is increased to 100 percent on previously compliant loans made prior to the effective date of this new guidance. The Agencies have revised the proposed question and answer accordingly. The Agencies anticipate that the universe of loans affected by this policy will be relatively small and diminishing due to refinancing and other loan prepayments that typically occur in the first five years of a home mortgage.

Proposed question and answer 25 (final question and answer 29) addressed what a lender that makes a loan on an individual condominium unit must do if there is no RCBAP coverage. Three commenters addressed this question and answer. One commenter suggested that, in the example, the Agencies should clarify that the amount of insurance required is the ``minimum amount'' because that value ($175,000) is based on the principal amount of the loan, which is less than either the insurable value of the unit ($200,000) or the maximum amount available in a dwelling policy ($250,000). In response to this comment, the Agencies have added the qualifier ``at least'' before the amount of $175,000 to clarify that $175,000 is the minimum amount of insurance that must be required. As in other situations, a lender may require additional coverage.

Another commenter asked whether a unit owner's dwelling policy will respond at all if there is no RCBAP on the condominium building. Although this is a general insurance question that is outside the Agencies' purview, FEMA guidance provides that, when there is no RCBAP coverage on the condominium building, the unit owner's dwelling policy will respond to losses to improvements owned by the insured and to assessments charged by the condominium association, up to the building coverage limits of the dwelling policy purchased.\7\ Finally, one other commenter suggested that, when a condominium association refuses to purchase an RCBAP, the lender should refuse to make a loan to a unit owner because the unit owner's dwelling policy is not adequate to protect the lender. The Agencies agree that there is risk to the lender in accepting a dwelling policy as protection for the collateral. However, this is a risk that the lender must weigh. Such policy, however, does fulfill the mandatory purchase requirement. The Agencies have amended the proposed question and answer to include additional discussion on dwelling policies in response to these comments. The
[[Page 35923]] Agencies otherwise adopt the question and answer as proposed.

\7\ See FEMA, Mandatory Purchase of Flood Insurance Guidelines at 48-49; FEMA Flood Insurance Manual at p. POL 8 (FEMA's Flood Insurance Manual is updated every six months).

Proposed question and answer 26 (final question and answer 30) discussed what a lender must do if the condominium association's RCBAP coverage is insufficient to meet the mandatory purchase requirements for a loan secured by an individual residential condominium unit. Several commenters suggested changes to FEMA's flood insurance policies. It is beyond the Agencies' jurisdiction to address these suggestions, which are within the purview of FEMA. Interested parties should appropriately consult with FEMA concerning the actual operation of flood insurance policies.

Several other commenters noted that the purchase of a unit owner's dwelling policy may not provide adequate coverage to the unit owner or the lender as a supplement to an RCBAP providing insufficient coverage to meet the mandatory purchase requirement. As noted in the proposed question and answer, a dwelling policy may contain claim limitations; therefore, it is incumbent upon a lender to understand these limitations.

Several commenters also suggested that the Agencies should not put forth guidance encouraging lenders to apprise borrowers that there is risk involved when flood coverage is maintained under a unit owner dwelling policy along with an RCBAP that does not provide replacement cost coverage. The Agencies believe that although insurance professionals are in the best position to adequately explain the implications of such coverage, lenders should still be encouraged to alert their borrowers to the risk. FEMA's brochure, National Flood Insurance Program: Condominium Coverage, may provide some helpful information for borrowers. The Agencies adopt the question and answer as proposed.

Proposed question and answer 27 (final question and answer 31) discussed what a lender must do when it determines that a loan secured by a residential condominium unit is in a complex with a lapsed RCBAP. One commenter requested that the Agencies provide more guidance on the steps a lender should take to determine if there is a lapse in existing RCBAP coverage. As mentioned above, the Agencies are aware that, generally, a lender that is the mortgagee of a unit owner's loan would not receive notice that the condominium association's RCBAP has expired. However, if a trigger event occurs (that is, the lender makes, increases, extends, or renews a loan to the borrower secured by the unit) or if the lender otherwise makes a determination that the RCBAP has expired, then the lender will be required to follow the procedure outlined in final question and answer 28 and discussed above. The Agencies adopt the question and answer as proposed.

Proposed question and answer 28 (final question and answer 32) provided examples of how the co-insurance penalty applies when an RCBAP is purchased at less than 80 percent of replacement cost value, unless the amount of coverage meets the maximum coverage of $250,000 per unit. Two commenters asked about the purpose of this question and answer. The Agencies intended this question and answer to provide information on the topic to lenders. The Agencies adopt the question and answer as proposed.

Proposed question and answer 29 (final question and answer 33) addressed the major factors that are involved with coverage limitations of the individual unit owner's dwelling policy with respect to the condominium association's RCBAP coverage. One commenter asked the purpose of this question and answer and further asserted that lenders should not be required to explain to borrowers about the limitations in coverage. The Agencies intended this question and answer to be informative in nature and agree that insurance professionals are in a better position to explain policy limitations to their policyholders. The Agencies adopt the question and answer as proposed.

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

Proposed Section VII addressed flood insurance requirements for home equity loans, lines of credit, subordinate liens, and other security interests in collateral located in an SFHA. The proposed questions and answers primarily proposed only minor wording changes or clarifications to questions and answers in the 1997 Interagency Questions and Answers without any change in the substance or meaning. Several commenters addressed questions and answers in this section.

Proposed question and answer 30 (final question and answer 34), addressed when a home equity loan is considered a designated loan that requires flood insurance. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 31 (final question and answer 35), addressed when a draw against an approved line of credit secured by property located in an SFHA requires flood insurance. Nine commenters questioned the statement that a designated loan requires a flood determination when application is made for that loan. The commenters noted that under the Act and Regulation, a lender or its servicer is responsible for performing a flood determination upon the making, increase, extension, or renewal of a loan, and not when a loan application is submitted. They further noted that applications are often withdrawn and that lenders usually have a flood determination performed when they are reasonably certain that one of the previously listed ``trigger'' events (e.g., the making or increasing) will occur. The commenters requested that this point be clarified. The Agencies agree with the commenters and are deleting the statement that a designated loan requires a flood determination when application is made for that loan. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 32 (final question and answer 36) addressed how much flood insurance is required when a lender makes a second mortgage secured by property located in an SFHA. Six commenters argued that a junior lienholder should not have to take senior liens into account when determining the required amount of flood insurance coverage. They asserted that the current requirement causes substantial cost and delay, resulting in an undue burden due to the need for either the junior lienholder or its servicer to engage in an expensive, time-consuming search for prior liens. One commenter contended that the question and answer should state that the amount of coverage for a junior lien would be 100 percent of the insurable value of the property. Alternatively, the same commenter suggested multiple flood insurance policies on buildings with multiple liens as a means to address the problem. On the other hand, one commenter believed that the question and answer should remind lenders to add secondary loans to any existing flood insurance policy's mortgagee clause. Three commenters requested more guidance on how and when a lienholder should determine the value of any other liens on improved collateral property. One of these mentioned closing or upon renewal of a loan as two possible dates for such activity.

The Agencies believe that, given the provisions of an NFIP policy, a lender cannot comply with Federal flood insurance requirements when it makes, [[Page 35924]] increases, extends, or renews a loan by requiring the borrower to obtain NFIP flood insurance solely in the amount of the outstanding principal balance of the lender's junior lien without regard to the flood insurance coverage on any liens senior to that of the lender. As illustrated in the examples in the question and answer, a junior lienholder's failure to take such a step can leave that lienholder partially or even fully unprotected by the borrower's NFIP policy in the event of a flood loss.

The final question and answer provides that a junior lienholder should work with the borrower, senior lienholder, or both these parties, to determine how much flood insurance is needed to adequately cover the improved real estate collateral to the lesser of the total of the outstanding principal balances on the junior loan and any senior loans, the maximum available under the Act, or the insurable value of the structure. The junior lienholder should also ensure that the borrower adds the junior lienholder's name as mortgagee/loss payee to an existing flood insurance policy.

The final question and answer also provides that a junior lienholder should obtain the borrower's consent in the loan agreement or otherwise for the junior lienholder to obtain information on balance and existing flood insurance coverage on senior lien loans from the senior lienholder. Commenters also contended that privacy concerns make it difficult for junior lienholders to obtain information from servicers or lenders about loan balances and existing flood insurance coverage. However, the Agencies have determined that the privacy provisions of the Gramm-Leach-Bliley Act, as implemented in the Agencies' regulations, do not prohibit sharing of the loan and flood insurance information between two lenders with liens on the same property, even without the borrower's consent.

One commenter noted that it is sometimes difficult to obtain information about the outstanding principal balance of other liens once a loan has been closed, such as at loan renewal, and asked what steps might be taken in that regard. The final question and answer states that junior lienholders have the option of obtaining a borrower's credit report to establish the outstanding balances of senior liens on property to aid in determining how much flood insurance is necessary upon increasing, extending or renewing a junior lien.

In the limited situation where a junior lienholder or its servicer is unable to obtain the necessary information about the amount of flood insurance in place on the outstanding balance of a senior lien (for example, in the context of a loan renewal), the final question and answer provides that the junior lienholder may presume that the amount of insurance coverage relating to the senior lien in place at the time the junior lien was first established (provided that the amount of flood insurance coverage relating to the senior lien was adequate at the time) continues to be sufficient.

The Agencies have revised the proposed question and answer to respond to these comments. The question and answer also provides examples illustrating the application of these methods of dealing with adequate flood insurance coverage for junior and senior liens. Specifically, the examples illustrate how a junior lienholder should handle situations such as: when a senior lienholder has obtained an inadequate amount of flood insurance coverage, when a senior lienholder is not subject to the Act's and Regulation's requirements; and when insurance coverage in the amount of the improved real estate's insurable value must be obtained by the junior lienholder.

Commenters also raised other issues related to ongoing flood insurance coverage on existing second lien loans in the context of force placement. The final question and answer addresses the triggering events of making, increasing, extending, and renewing a second lien loan.

Proposed question and answer 33 (final question and answer 37) addressed flood insurance requirements in connection with home equity loans secured by junior liens. Ten commenters requested that the question and answer be clarified to address other subordinate lien loans, not just junior lien home equity loans. The Agencies agree with the commenters and, therefore, have revised the question and answer to clarify that it applies to all subordinate lien loans.

Another commenter recommended that the ``same lender'' exception also apply to a lender's affiliates. The Act provides that a person who increases, extends, renews, or purchases a loan secured by improved real estate or a mobile home may rely on a previous determination of whether the building or mobile home is located in an area having special flood hazards, if the previous determination was made no more than seven years before the date of the transaction and there have been no subsequent map revisions. 42 U.S.C. 4104b(e). The Act further defines the term ``person'' to include any individual or group of individuals, corporation, partnership, association, or any other organized group of persons, including State and local governments and agencies thereof. 42 U.S.C. 4121(a)(5). The Agencies do not interpret the definition as providing for the inclusion of affiliates within a corporate entity as constituting a single ``person'' except for treating a regulated lending institution and its operating subsidiaries as a single entity. The Agencies believe that no further revision of the question and answer is appropriate on this point. The Agencies adopt the question and answer as proposed subject to the revisions discussed above.

Proposed question and answer 34 (final question and answer 38) addressed the issue of whether a loan secured by inventory stored in a building located in an SFHA, when the building is not collateral for the loan, requires flood insurance. One commenter asked what sort of legal instrument would have to be filed by a lender to result in the need for flood insurance coverage for a borrower's contents. The Agencies decline to respond to this inquiry because it involves a business and legal decision beyond the interpretation of the Act and Regulation. The Agencies adopt the question and answer as proposed.

Proposed question and answer 35 (final question and answer 39) addressed flood insurance requirements when building contents are security for a loan. Seven commenters requested further guidance and clarification on how to calculate flood insurance contents coverage in compliance with Federal regulation. Five commenters specifically requested that the Agencies give examples to illustrate how flood insurance coverage works for building and contents. Two commenters asked whether a lender should consider the total amount of coverage for both contents and building together or should consider the two separately. One commenter asked whether a lender could do the same with contents and building coverage as is the practice with coverage for multiple buildings, that is, the contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes as long as some amount of insurance is allocated to each category.

The Agencies agree that the practice for flood insurance coverage for multiple buildings would also be applicable to coverage for both contents and building. That is, both contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes as long as some reasonable amount of insurance [[Page 35925]] is allocated to each category. The Agencies have added an example to this question and answer to illustrate this point. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 36 (final question and answer 40), addressed the flood insurance requirements applicable to collateral or contents that do not secure a loan. The Agencies did not receive any substantive comments and adopt it as proposed.

Proposed question and answer 37 (final question and answer 41) addressed the Regulation's application where a lender places a lien on property out of an ``abundance of caution.'' One commenter recommended that flood insurance coverage should not be required when an interest is taken by a lender in improved real estate in a flood hazard zone out of an ``abundance of caution.''

The Agencies decline to accept this recommendation. The Act provides that a lender may not make, increase, extend, or renew any loan secured by improved real estate or a mobile home in a flood hazard area unless the building or mobile home is covered for the term of the loan by flood insurance. 40 U.S.C. 4012a(b)(1). The statute makes no exception for property taken as collateral by a lender out of an abundance of caution. The Agencies adopt the question and answer as proposed.

Proposed question and answer 38 (final question and answer 42) addressed loans secured by a note on a single-family dwelling, but not the dwelling itself. Proposed question and answer 39 (final question and answer 43) pertained to loans personally guaranteed by a third party who gave the lender a security interest in improved real estate owned by the guarantor. One commenter stated that the two proposed questions and answers conflicted. The Agencies do not believe there is a conflict between the two questions and answers. In the former question and answer, the Agencies concluded that Federal flood insurance requirements did not apply because the loan was not secured by improved real estate, but was instead secured by a note. In the latter question and answer, the lender was given a security interest in improved real estate by a third party in connection with the third party providing a personal guarantee on a loan. In each situation, the absence or presence of a security interest in improved real estate determined whether Federal flood insurance requirements would apply. The Agencies believe that no further elaboration is necessary and adopt these questions and answers as proposed.

Section VIII. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or Its Servicing Rights

Proposed Section IX (final Section VIII) addressed flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights. This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers, and any changes proposed by the Agencies in the March 2008 Proposal were designed to provide greater clarity with no intended change in substance and meaning. The comments received by the Agencies regarding the questions and answers in this section were generally supportive.

Proposed question and answer 41 (final question and answer 44) addressed the application of the flood insurance requirements under the Regulation to lenders/loan servicers under different scenarios. Upon consideration of the various comments, the Agencies have clarified the question and answer to apply to both regulated and nonregulated lenders. One commenter was supportive of the guidance, but recommended that lenders be allowed to assign a certain level of responsibility for flood insurance compliance through contractual arrangements to the servicer. The commenter asserted that this approach would not absolve lenders of liability and ultimate responsibility, but would make for a less burdensome and logical approach. The Agencies believe that the lender's responsibilities are sufficiently clear in the question and answer and that further elaboration on this point is unnecessary.

Another commenter asked that the Agencies expressly indicate that no servicing obligations need be followed by a lender who has sold both the loan and the servicing rights to a nonregulated party. The Agencies have elected to clarify in the answer that once the regulated lender has sold the loan and the servicing rights, the lender has no further obligation regarding flood insurance on the loan. The Agencies have also elected to clarify in the answer that, depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake sufficient due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. Moreover, if the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the Act and Regulation. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 42 (final question and answer 45), addressed when a lender is required to notify FEMA or the Director's designee. Proposed question and answer 43 (final question and answer 46), addressed whether a RESPA Notice of Transfer sent to the Director of FEMA satisfies the Act and Regulation. The Agencies received one comment that was supportive of these proposed questions and answers. The Agencies adopt the questions and answers as proposed.

Proposed question and answer 44 (final question and answer 47), indicated that delivery of the notice can be made electronically, including by batch transmission if acceptable to the Director or the Director's designee. The Agencies did not receive any substantive comments and adopt this question and answer as proposed.

Proposed question and answer 45 (final question and answer 48) indicated that if a loan and its servicing rights are sold by the lender, the lender is required to provide notice to the FEMA Director or the Director's designee. The Agencies received one comment that was supportive of the proposed question and answer. The Agencies adopt the question and answer as proposed.

Proposed question and answer 46 (final question and answer 49), indicated that a lender is not required to provide notice when the servicer, not the lender, sells or transfers the servicing rights to another servicer; rather the servicer is obligated to provide the notice. Proposed question and answer 47 (final question and answer 50) indicated that in the event one institution is acquired by or merges with another institution, the duty to provide the notice for loans being serviced by the acquired institution falls to the successor institution if notification is not provided by the acquired institution prior to the effective date of the acquisition or merger. The Agencies received one comment that was supportive of these proposed questions and answers. The Agencies adopt the questions and answers as proposed.

Section IX. Escrow Requirements

Proposed Section X (final Section IX) addressed escrow requirements for flood insurance premiums. This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers, and any changes proposed by the Agencies were designed to provide [[Page 35926]] greater clarity with no intended change in substance and meaning. The Agencies received few comments on this section.

Proposed question and answer 48 (final question and answer 51), addressed when multifamily buildings and mixed-use properties are considered residential real estate. A financial institution commenter requested two clarifications. First, the commenter noted that the proposed answer indicated that lenders are required to escrow flood insurance premiums and fees for any mandatory flood insurance for designated loans if the lender requires the escrow of taxes, hazard insurance premiums, ``or other loan charges'' for loans secured by residential improved real estate. The commenter questioned whether lenders are required to escrow flood insurance premiums and fees for any mandatory flood insurance for designated loans if the lender requires the escrow of mortgage insurance premiums. The Agencies believe that escrowing flood insurance premiums and fees for mandatory flood insurance for designated loans is required by the Act and
Regulation where the lender requires the escrowing of mortgage insurance premiums. The Act and Regulation require escrowing if a regulated lending institution requires the escrowing of ``taxes, insurance premiums, fees, or any other charges.'' Mortgage insurance is a form of insurance. It is also an ``other charge'' under the Regulation. To provide greater consistency with the Act and Regulation, the Agencies are inserting the word ``any'' into the answer so that it refers to taxes, insurance premiums, fees, ``or any other charges.''

The commenter also asked the Agencies to expressly state in the answer that a lender is not required to escrow flood insurance premiums if it chooses to make an exception on a loan-by-loan basis not to escrow other items such as taxes, hazard insurance premiums, or other loan charges. In response, the Agencies have added a sentence to the answer providing that a lender is not required to escrow flood insurance premiums and fees for a particular loan if it does not require escrowing of any other charges for that loan.

Finally, because the Agencies are adopting questions and answers providing examples of residential and nonresidential properties, the discussion of mixed-use properties has been revised to refer the reader to those questions and answers. If the primary use of a mixed-use property is for residential purposes, the Regulation's escrow requirements apply. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 49 (final question and answer 52) addressed when escrow accounts must be established for flood insurance purposes and indicated that escrow accounts should look to the definition of ``Federally related mortgage loan'' contained in the Real Estate Settlement Procedures Act (RESPA) to see whether a particular loan is subject to RESPA's escrow requirements. The Agencies did not receive any substantive comments on the proposed question and answer; however, the Agencies made nonsubstantive revisions to the answer to more directly respond to the question asked and to provide additional clarity.

The Agencies received no comments on proposed questions and answers 50 and 51 (final questions and answers 53 and 54 respectively). Proposed question and answer 50 (final question and answer 53) indicated that voluntary escrow accounts established at the request of the borrower do not trigger a requirement for the lender to escrow premiums for required flood insurance. Proposed question and answer 51 (final question and answer 54) indicated that premiums paid for credit life insurance, disability insurance, or similar insurance programs should not be viewed as escrow accounts requiring the escrowing of flood insurance premiums. The Agencies did not receive any substantive comments on these questions and answers and adopt them as proposed.

Proposed question and answer 52 (final question and answer 55) advised that only certain escrow-type accounts for commercial loans secured by multifamily residential buildings trigger the escrow requirement for flood insurance premiums. The Agencies did not receive any substantive comments and adopt this question and answer as proposed.

Proposed question and answer 53 (final question and answer 56) addressed escrow requirements for condominium units covered by RCBAPs. The Agencies received several comments on this question and answer. Two financial institution commenters reiterated their comments pertaining to proposed question and answer 24 (final question and answer 28) that lenders or servicers of a loan to a condominium unit owner do not receive a copy of the RCBAP renewal information because they are not loss payees on the policy. This comment was addressed in the SUPPLEMENTARY INFORMATION pertaining to Section VI above. A financial institution requested clarification that regardless of whether the lender makes a loan for the purchase or refinance of a condominium unit, an escrow account is not required if dues to the condominium association apply to the RCBAP premiums. The proposed question and answer only addressed purchase loans; however, the Agencies agree with the commenter that the same principle should apply to refinancings. The Agencies, therefore, are clarifying the question and answer to provide that when a lender makes, increases, renews, or extends a loan secured by condominium unit that is adequately covered by an RCBAP, and dues to the condominium association apply to the RCBAP premiums, an escrow account is not required. However, if the RCBAP coverage is inadequate and the unit is also covered by a dwelling form policy, premiums for the dwelling form policy would need to be escrowed. The Agencies otherwise adopt the question and answer as proposed.

X. Force Placement of Flood Insurance

Proposed Section XI (final Section X) addressed issues concerning the force placement of flood insurance. This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers and any changes proposed by the Agencies in March 2008 were designed to provide greater clarity with no intended change in substance and meaning.

The Agencies received several comments on proposed question and answer 54 (final question and answer 57), which provided general guidance on the force placement requirement under the Act and Regulation. Six commenters requested further guidance regarding the exact point at which lenders must commence the force placement process. Similarly, commenters requested clarification as to precisely when the 45-day notice period begins after which a lender or its servicer must force place insurance. One of these commenters specifically asked the Agencies to clarify whether insurance is required 45 days from the date the institution received the cancellation notice, the date of cancellation on that notice, or the date that the borrower receives notice from the lender or servicer. One commenter requested clarification from the Agencies whether the 45-day notice could be sent prior to the actual date of expiration of flood insurance coverage.

As discussed in the proposed question and answer, the Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the [[Page 35927]] improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider. The notice to the borrower must also state that if the borrower does not obtain the insurance within the 45-day period, the lender will purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees to obtain the coverage. The Act does not permit a lender or its servicer to send the required 45-day notice to the borrower prior to the institution's making a determination that flood insurance is insufficient or lacking (for example, the actual expiration date of the flood insurance policy). If adequate insurance is not obtained by the borrower within the 45-day period, then the insurance must be obtained by the lender on behalf of the borrower.

Another commenter stated that if a lender decides to pay a borrower's current policy premium, this should not be considered to be purchasing a force placed policy. The Agencies agree that it is within a lender's discretion to absorb the costs of a borrower's flood insurance policy anytime during the term of the designated loan. This should not, however, eliminate the borrower's opportunity to obtain appropriate flood insurance coverage, especially during the 45-day period after receiving a force placement notice from the lender. The Agencies revised proposed question and answer 54 (final question and answer 57) to address these commenters' points.

The Agencies also received questions from commenters regarding coverage during the 45-day notice period. Two commenters asked how to ensure that collateral property is protected against flood damage during the 45-day notice period prior to actual force placement. Another commenter asked for more explanation about the coverage that continues in effect for 30 days after the date that a Standard Flood Insurance Policy (SFIP) expires under the NFIP.

Coverage under FEMA's SFIP continues in effect for 30 days from the date that the SFIP lapses. An SFIP specifically provides that, if the insurer decides to cancel or not renew a policy, it will continue in effect for the benefit of only the mortgagee for 30 days after the insurer notifies the mortgagee of the cancellation or nonrenewal. No coverage will be provided for a borrower under the SFIP during this 30-day period. If a lender monitors a mortgage loan with respect to the need for flood insurance coverage, the lender can time the 45-day period to start with the lapse of insurance coverage. Assuming notification is made immediately upon policy cancellation or nonrenewal, coverage will continue in place for the lender/mortgagee's benefit for 30 days of the 45-day notice period. To cover the risk during the remaining 15-day ``gap,'' lenders may purchase private flood insurance to cover the collateral property, as discussed further in section XI below regarding private insurance policies. Lenders in these situations, often purchase what is known in the insurance industry as a ``30-day binder,'' a form of temporary private insurance. The insurance provided by such a binder will cover the 15-day gap and the 15 days subsequent to the end of the notice period. Because these issues lie outside the scope of the Agencies' purview, however, the Agencies decline to include this guidance in the question and answer.

One commenter contended that one of the criteria for force placement in proposed question and answer 54 (final question and answer 57) should be changed from ``[t]he community in which the property is located participates in the NFIP'' to ``flood insurance under the Act is available for improved property securing the loan,'' because properties may also be in Coastal Barrier Resource Areas, Otherwise Protected Areas, or areas designated under section 1316 of the Flood Act. The Agencies have revised final question and answer 57 to reflect this requested change. Another commenter asked whether the citation to ``Appendix A of the FEMA publication'' in proposed question and answer 54 was a reference to the immediately previously cited FEMA procedures that were published in the Federal Register. The Agencies have revised final question and answer 57 to clarify the citation.

Proposed question and answer 55 (final question and answer 58), addressed whether a servicer can force place insurance on behalf of a lender. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 56 (final question and answer 59) addressed the amount of insurance required when force placement occurs. The Agencies received one comment suggesting that the proposed answer to proposed question 56 not only cross-reference Section II of the Interagency Questions and Answers, but also refer to Section VII, because proposed question and answer 36 in that section pertains to the required amount of flood insurance for home equity loans. The Agencies have made minor clarifications based upon this comment, but otherwise
adopt the question and answer as proposed.

The Agencies received comments regarding terminology used in this section. Specifically, two commenters took exception to the use of the term ``force placement,'' arguing that the term conveys an incorrect impression that the borrower is being forced to accept the purchase of flood insurance coverage when the reverse of the situation applies. These commenters suggested that the alternative term ``lender placed'' should be used instead. The current term ``force placement'' is used in the Regulation. Moreover, the term has been widely used since the enactment of the National Flood Insurance Reform Act of 1994. Changing the term may cause confusion. For this reason, the Agencies decline to accept this suggested change.

Another commenter recommended that ``lender single interest policies'' should not be allowed and should be considered in violation of the legal requirements of the Act and Regulation since they are not purchased on the borrower's behalf and do not offer the same or better policy terms to the borrower. As discussed in further detail in the discussion to section XI below, private insurance policies may only be considered an adequate substitute for an SFIP if the policy meets the criteria set forth by FEMA, including the requirement that the coverage be as broad as an SFIP. The Agencies have declined to address this comment specifically because it is believed that the comment is addressed by the general guidance in section XI.

In response to comments received regarding the force placement of flood insurance, the Agencies are proposing three new questions and answers (60, 61, and 62), which are discussed in the SUPPLEMENTARY INFORMATION immediately following the Redesignation Table, to be added to Section VII to address the following force-placement issues: when action after learning that improved real estate that secures a loan is uninsured or underinsured, and whether a borrower may be charged for the cost of flood insurance coverage during the 45-day notice period.

XI. Private Insurance Policies

Proposed Section XII (final Section XI) addressed the appropriateness of gap or blanket insurance policies, often purchased by lenders to ensure adequate life-of-loan flood insurance coverage for designated loans. The proposed answer to question 57 (final [[Page 35928]] question and answer 63) explained, generally, that gap or blanket insurance is not an adequate substitute for NFIP insurance. The proposed answer, however, did acknowledge that in limited circumstances, a gap or blanket policy may satisfy flood insurance obligations in instances where NFIP and private insurance for the borrower are otherwise unavailable.

The Agencies received several comments regarding the proposed question and answer. Some industry commenters argued that gap or blanket insurance is a cost-effective alternative to NFIP insurance and should be permitted as a substitute for NFIP insurance in all cases. Other industry commenters argued that gap or blanket insurance should be permitted as a substitute for NFIP insurance under certain circumstances, such as for construction loans or underinsured properties. Still other industry commenters asked the Agencies to clarify the use of the terms ``gap'' and ``blanket'' policies, noting that the common industry understanding is that ``gap'' policies are distinguishable from ``blanket'' policies. In particular, these commenters requested that the Agencies eliminate the prohibition on ``gap'' policies that are meant to cover the deficiency between a borrower's coverage and the amount of insurance required under the Act and Regulation. One industry commenter also noted that there are different types of ``gap'' policies and suggested that the Agencies clarify its intentions to prohibit only certain types of ``gap'' policies. Lastly, commenters also requested general guidance on whether non-NFIP private insurance policies were permitted.

Based on these comments, the Agencies have decided to modify the question and answer to address broader issues of the appropriateness of private insurance. Instead of focusing on whether a policy is called a ``gap'' insurance policy or a ``blanket'' insurance policy, which may depend on how the policy is marketed by the insurer, the Agencies have decided that it is more appropriate to provide guidance to lenders on private insurance policies in general.

The Agencies have revised the answer to the question to provide that a private insurance policy may be an adequate substitute for an NFIP policy if it meets the criteria set forth by FEMA in its Mandatory Purchase of Flood Insurance Guidelines.\8\ As FEMA has stated in its Mandatory Purchase of Flood Insurance Guidelines, to the extent there are any differences between the private insurance policy and an NFIP Standard Flood Insurance Policy, those differences must be evaluated carefully by the lender to determine whether the policy would provide sufficient protection under the Act and Regulation. Lenders must consider the suitability of a private insurance policy only when the mandatory purchase requirements apply. Therefore, if the Act or Regulation does not require the purchase of flood insurance, the lender need not evaluate the policy to determine whether it meets the criteria set forth by FEMA.

\8\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 57-58.

The guidance proposed in March 2008 on the limited circumstances when gap or blanket policies are permissible has been revised and is being addressed in a new separate question and answer 64. The answer to final question 64 provides that in the event that a flood insurance policy has expired and the borrower has failed to renew coverage, a private insurance policy that does not meet the criteria set forth by FEMA may nevertheless be useful in protecting the lender during a gap in coverage in the period of time before a force placed policy takes effect. However, the answer further states that the lender must force place NFIP-equivalent coverage in a timely manner and may not rely on non-equivalent coverage on an on-going basis. This is consistent with guidance proposed in March 2008, though the language has been modified in response to commenters who thought this guidance was confusing as worded in the proposal.

Section XII. Required Use of the Standard Flood Hazard Determination Form (SFHDF)

Proposed Section XIII (final Section XII) addressed the required use of the Special Flood Hazard

Determination Form (SFHDF). This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers. The changes proposed by the Agencies in March 2008 were designed to provide greater clarity with no intended change in substance and meaning. The agencies received a number of comments on this section.

Proposed question and answer 58 (final question and answer 65), addressed whether the SFHDF replaces the borrower notification form. One commenter suggested the answer clarify the SFHDF's use to the lender and the notification form's use to benefit the borrower. The Agencies agree with the commenter and have revised the proposed answer to be more responsive to the question and to more clearly set out the respective uses of the SFHDF and the borrower notification form. Information about the notice of special flood hazards may be found in section XV. The commenter also suggested that the Agencies should amend the proposed answer to provide that the SFHDF must be used by the lender to determine if the ``improved'' property securing the loan is
located in an SFHA. The Regulation specifically provides that a lender must make a flood hazard determination and use the SFHDF when determining whether the ``building or mobile home offered as collateral security for a loan is or will be located in an SFHA in which flood insurance is available under the Act.'' The Agencies agree that it is appropriate to revise the proposed question and answer to conform to the language of the Regulation and have done so.

Proposed question and answer 59 (final question and answer 66), addressed whether a lender is required to provide a copy of the SFHDF to the applicant/borrower. The Agencies received two comments concerning the proposed question and answer. The commenters suggested that the answer should state that the Act does not require that the lender provide the borrower with a copy of the SFHDF. The Agencies have revised the proposed question and answer to note that, while not a statutory requirement, a lender may provide a copy of the flood determination to the borrower so the borrower can provide it to the insurance agent in order to minimize flood zone discrepancies between the lender's determination and the borrower's policy. A lender would also need to make the determination available to the borrower in case of a special flood hazard determination review, which must be requested jointly by the lender and the borrower. In the event a lender provides
the SFHDF to the borrower, the signature of the borrower is not required to acknowledge receipt of the form.

Proposed question and answer 60 (final question and answer 67) addressed the use of the SFHDF in electronic format. The Agencies did not receive any substantive comment and adopt the question and answer as proposed.

Proposed question and answer 61 (final question and answer 68) addressed the circumstances when a lender may rely on a previous special flood hazard determination. The Agencies received several comments concerning this question and answer. One commenter suggested that, if a lender maintains life-of-loan tracking, there is little benefit in obtaining a new special flood hazard determination [[Page 35929]] when renewing, refinancing, or extending a loan if the original determination is older than seven years. The authority to rely on a previous determination made within the previous seven years if that determination meets certain requirements is statutory (42 U.S.C. 4104b(e)). Accordingly, seven years is the maximum period during which a lender may rely on a previous determination, even if the lender has maintained life-of-loan tracking.

Two commenters suggested that the proposed question and answer should also address whether a lender may rely on one determination if a lender makes multiple loans to one borrower, all of which are secured by the same improved property. For example, it should address when a lender may rely on a single determination when making a home purchase loan and a subsequent home equity loan, both secured by the same residence. The situation described by the commenters is similar to the example of a refinancing or assumption by a lender, which obtained the original flood determination on the same security property. In that case, the question and answer states that the lender may rely on the original determination if the original determination was made not more than seven years before the date of the transaction, the basis of the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made. The Agencies based this interpretation on the premise that a refinancing would be the functional equivalent of either a loan extension or renewal. Subsequent loans to the same borrower secured by the same improved real estate could be deemed to be the functional equivalent of increasing the amount of the original loan. Therefore, if the original etermination was made not more than seven years before the date of the transaction, the basis of the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made, a lender may similarly rely on a previous determination if the lender makes multiple loans that are secured by the same building or mobile home. The Agencies have revised the proposed question and answer to also address subsequent loans by the same lender secured by the same improved real estate.

Section XIII. Flood Determination Fees

Proposed Section XIV (final Section XIII) consisted of proposed questions and answers 62 and 63 (final questions and answers 69 and 70 respectively), which addressed fees charged when making a flood determination and charging fees to cover life-of-loan monitoring of a loan, respectively. The Agencies received two comments on these questions and answers. One commenter supported them; the other commenter asked whether a lender could charge an up-front, nonrefundable, composite determination and life-of-loan fee regardless of whether the loan application closes. The Act and Regulation allow a lender to charge a reasonable fee for determining whether a building or mobile home securing a loan is located or will be located in a special flood hazard area if the determination is made in connection with the making, increasing, extending, or renewing of a loan that is initiated by the borrower. In the commenter's situation, the Agencies would agree that a fee for an initial determination could be charged when the determination is procured in connection with an application initiated by an applicant, even if the application does not close. However, a lender cannot charge a life-of-loan fee if the application does not close. Such a fee would be an unearned fee and, as such, charging such a fee would be prohibited by section 8 of RESPA. Therefore, a lender may not charge a nonrefundable, composite determination and life-of-loan fee when a loan application does not close. The Agencies have adopted the former question and answer as proposed. The Agencies have revised the latter question and answer in response to the comment.

Section XIV. Flood Zone Discrepancies

Proposed Section XV (final Section XIV) addressed flood zone discrepancies between the flood hazard designation documented by the lender on the SFHDF and the one documented on the flood insurance policy and used to rate the policy. There were numerous negative comments concerning the Agencies' proposed guidance for dealing with such discrepancies.

Proposed question and answer 64 (final question and answer 71) addressed lenders' recourse when confronted with a flood zone discrepancy. Nineteen commenters were generally opposed to the proposed treatment of a discrepancy as set forth in the proposed question and answer. Several of these commenters argued that the Act does not require lenders to identify and resolve flood zone discrepancies and ensure that a flood insurance policy is properly rated. Other commenters argued that it is an undue burden to expect financial institutions to resolve discrepancies between the SFHDF and the flood insurance policy. Six commenters maintained that it is an insurance agent's responsibility to determine the correct flood zone and that a lender should not be responsible for auditing an NFIP-authorized insurance agent. These commenters argued that requiring lenders to document every flood zone discrepancy would be costly and burdensome and require extensive loan servicing system changes.

Two commenters stated that the Agencies need to clearly define ``zone discrepancy.'' Another commenter asked what action would be required to correct any ``violation'' and further inquired how much flood insurance should be force placed in such a situation if a lender wants to correct a discrepancy by means of force placement. Two other commenters said that a borrower will not want to obtain a Letter of Determination Review from FEMA at a cost of $80 when there is a dispute between the lender and insurance company over a flood zone discrepancy, while three other commenters noted that it is unreasonable to expect the parties to wait 45 days for a FEMA determination review. Finally, two commenters noted that if a coverage error occurs, the borrower or lender may reconcile this through payment of the premium differential (the amount of premium that would have been charged if the policy had been correctly rated) or FEMA may reduce the amount of claim payment.

The Agencies disagree with those commenters who argued against a lender being responsible for resolving flood zone designation discrepancies, either as a legal matter or because the requirement would be burdensome and costly. The Agencies agree, and FEMA concurs, that Federal law places the ultimate responsibility to ensure appropriate flood insurance coverage on the lender. The Agencies note that, although coverage errors can be mitigated after a flood loss by paying premium differentials or reducing the claim payment, these mitigation techniques do not relieve a lender of the responsibility to ensure that an appropriate amount of flood insurance coverage is in place when a loan is made.

Commenters, however, raised valid points with respect to the proposed process for resolving flood zone [[Page 35930]] discrepancies. To address these points, the Agencies have revised final question and answer 71 to specify that lenders need only address discrepancies between high-risk zones (Zones A or V) and moderate- or low-risk zones (Zones B, C, D, or X). The revised question and answer further specifies the actions a lender should take if such a zone discrepancy is found to exist. Those steps continue to include attempting to determine whether the discrepancy is a result of a legitimate reason, such as grandfathering, or is a mistake. In certain circumstances, submitting a request for a Determination Review to FEMA may be an appropriate means of resolving discrepancies; however, it is not required in all situations. The question and answer explains that if the discrepancy is not resolved, the lender should send a letter to the insurance agent and/or the insurance company reminding them of FEMA's April 16, 2008, instruction that, in cases of determination discrepancies, the policy should be written to cover the higher risk zone. Beyond that, no further action by the lender is required. If, for its own purposes, the lender believes force placement is appropriate, then it should consult the guidance on that topic found in Sections II and X.

Proposed question and answer 65 (final question and answer 72), addressed whether lenders can be found in violation of the Act and Regulation for flood zone discrepancies. Seven commenters either registered their opposition to the proposed question and answer or recommended that it be deleted outright. These commenters argued, similar to their comments on proposed question and answer 64, that the lender is the wrong person to resolve flood zone discrepancies, that it is instead the responsibility of the insurance agent and the company issuing the flood insurance policy to ensure that the flood zone is correct, and that imposing this requirement on lenders is an unnecessary burden not mandated by law. Another commenter argued that by sanctioning lenders for not successfully identifying and resolving flood zone discrepancies, the two proposed questions and answers would create a duty to ensure that the flood policy is rated properly that does not presently exist under the Act or the Regulation.

As noted above, the Act and the Regulation require lenders to ensure that an appropriate amount of flood insurance coverage is purchased; lenders, therefore, should take steps to identify and address flood zone discrepancies. If a pattern or practice of unresolved discrepancies is found in a lender's loan portfolio, due to a lack of effort on the lender's part to resolve such discrepancies using the process outlined in final question and answer 71, the Agencies may cite the lender for a violation of the mandatory purchase requirements.

Section XV. Notice of Special Flood Hazards and Availability of Federal Disaster Relief

Proposed Section XVI (final Section XV) addressed the notice of special flood hazards and the availability of Federal disaster relief that lenders are generally required to provide to borrowers. The proposed questions and answers primarily proposed only minor wording changes or clarifications to questions and answers in the 1997 Interagency Questions and Answers without any change in the substance or meaning.

Proposed question and answer 66 (final question and answer 73), addressed whether the notice had to be provided to each borrower for each real estate related loan. The proposed answer explained that in a transaction involving multiple borrowers, the lender is only required to send notice to one borrower, but may provide multiple notices if the lender chooses. The Agencies received a comment on a related issue asking who should receive the notice if, at the time of increase, real estate collateral has been hypothecated by a guarantor as security on the borrower's loan. If a lender takes a security interest in improved real estate owned by a guarantor (not simply pledged by a guarantor) located in an SFHA, then flood insurance is required and the notice should be sent to both the borrower and the guarantor.

Another commenter asked when borrowers have to be notified that their secured property is in a flood zone. The commenter noted that their examiners have previously said ten days prior to loan closing. As noted in the Regulation, lenders are required to provide notice within a reasonable time before completion of the transaction (loan closing). What constitutes ``reasonable'' notice will necessarily vary according to the circumstances of particular transactions. Regulated lending institutions should bear in mind, however, that a borrower should receive notice timely enough to ensure that (1) the borrower has the opportunity to become aware of the borrower's responsibilities under the NFIP; and (2) where applicable, the borrower can purchase flood insurance before completion of the loan transaction. In light of these considerations, the final question and answer does not establish a fixed time period during which a lender must provide the notice to the borrower. The Agencies generally continue to regard ten days as a ``reasonable'' time interval. The Agencies adopt the question and answer as proposed.

Proposed question and answer 67 (final question and answer 74) addressed how the notice requirement applied to loans secured by mobile homes where the location of the mobile home may not be known until just prior to, or sometimes after, the loan closing. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 68 (final question and answer 75), addressed when the lender is required to provide notice to the loan servicer that flood insurance is required. Proposed question and answer 69 (final question and answer 76) addressed what constitutes appropriate notice to the loan servicer. Proposed question and answer 70 (final question and answer 77) addressed whether it was necessary for the lender to provide notice to a loan servicer affiliated with the lender. Proposed question and answer 71 (final question and answer 78) addressed how long a lender has to maintain the record of receipt by the borrower of the notice. The Agencies received one comment that was supportive of these proposed questions and answers. The Agencies adopt the questions and answers as proposed.

Proposed question and answer 72 (final question and answer 79), addressed whether a lender can rely on a previous notice that is less than seven years old and was given to the same borrower for the same property by the same lender. Two commenters stated that lenders should be able to waive a notice to a borrower when they already have adequate flood insurance and one commenter said that notice should not be required when there has not been a change in the flood map. The Act and Regulation require lenders to send notice when a lender makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area. Therefore, as a statutory requirement, the notice may not be waived.
The Agencies adopt the question and answer as proposed.

Proposed question and answer 73 (final question and answer 80), addressed whether the use of the sample form of notice is mandatory. The Agencies received one comment that was supportive of the proposed question and answer; however, another commenter asked whether lenders [[Page 35931]] should use the revised version of the Sample Form of the Notice
provided by FEMA in 2007 or the sample notice that accompanies the Regulation. The Agencies do not require the use of a specific form so long as the form contains the required information as specified by the Act and Regulation. The Agencies revised the answer, to reflect that the sample form of the notice provided by FEMA in its Mandatory Purchase of Flood Insurance Guidelines is also not required to be used.

Section XVI. Mandatory Civil Money Penalties

Proposed Section XVII (final Section XVI) addressed the imposition of mandatory civil money penalties for violations of the flood insurance requirements. Proposed question and answer 74 (final question and answer 81) listed the sections of the Act that trigger mandatory civil money penalties when examiners find a pattern or practice of violations of those sections and included information about statutory limits on the amount of such penalties. The Agencies did not receive any comments and adopt the question and answer as proposed.

Proposed question and answer 75 (final question and answer 82) addressed the general standards the Agencies consider when determining whether violations constitute a pattern or practice for which civil money penalties are mandatory. The Agencies received one industry trade group comment suggesting that proposed question and answer 75 be amended to clarify that the assessment of civil money penalties be based on an overall assessment of the entire loan portfolio and not randomly selected representations. The Agencies believe that the guidance in this question and answer properly sets forth the general standards the Agencies consider when determining whether a pattern or practice of violations has occurred. As discussed in the March 2008 Proposed Interagency Questions and Answers, the considerations listed in the proposed question and answer are not dispositive of individual cases, but serve as a reference point for reviewing the particular
facts and circumstances. The Agencies adopt the question and answer as proposed.

Redesignation Table

The following redesignation table is provided as an aid to assist the public in reviewing the revisions to the 1997 Interagency Questions and Answers.

1997 Interagency	Current questions and answers

questions and answers

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Section I. Definitions.................... ....

Section I, Question 1..................... Section IV, Question 20.

Section I, Question 2..................... Section IV, Question 19.

Section I, Question 3..................... Section VII, Question 34.

Section I, Question 4..................... Section VII, Question 35.

Section I, Question 5..................... Section VII, Question 38.

Section I, Question 6..................... Section VII, Question 39; and Section VII, Question 40.

Section I, Question 7..................... Section VII, Question 41.

Section I, Question 8..................... Section VII, Question 42.

Section I, Question 9..................... Section I, Question 5.

Section I, Question 10.................... Section VII, Question 43.

Section II. Requirement
to Purchase Flood
Insurance Where Available. ....

Section II, Question 1.................... Section I, Question 1.

Section II, Question 2.................... Section I, Question 3.

Section II, Question 3.................... Section I, Question 6.

Section II, Question 4.................... Deleted as obsolete.

Section II, Question 5.................... Section II, Question 15.

Section II, Question 6.................... Section VIII, Question 44.

Section II, Question 7.................... Section II, Question 14; and Section V, Question 25.

Section II, Question 8.................... Section VI, Question 28.

Section II, Question 9.................... Section VI, Question 31.

Section III. Exemptions.................. Section III. Exemptions from the mandatory flood insurance requirements.

Section III, Question 1................... Section III, Question 18.

Section IV. Escrow .... Section IX. Escrow requirements.
Requirements

Section IV, Question 1.................... Deleted as obsolete.

Section IV, Question 2.................... Section IX, Question 51.

Section IV, Question 3.................... Section IX, Question 52.

Section IV, Question 4.................... Section IX, Question 53.

Section IV, Question 5.................... Section IX, Question 54.

Section IV, Question 6.................... Section IX, Question 55.

Section IV, Question 7.................... Section IX, Question 56.

Section V. Required Use................ Section XII. Required use of Standard Flood Hazard Determination Form (SFHDF).
of Standard Flood
Hazard Determination
Form (SFHDF).

Section V, Question 1..................... Section XII, Question 65.

Section V, Question 2..................... Section XII, Question 66.

Section V, Question 3..................... Section XII, Question 67.

Section V, Question 4..................... Section XII, Question 68.

Section V, Question 5..................... Section VII, Question 36; and Section VII, Question 37

Section VI. Force Placement.......... Section X. Force placement of flood insurance.
of Flood Insurance.

Section VI, Question 1.................... Section X, Question 57.

Section VI, Question 2.................... Section X, Question 58.
Section VI, Question 3.................... Section X, Question 59.
Section VII. Determination Fees...... Section XIII. Flood determination fees.
Section VII Question 1.................... Section XIII, Question 69.
Section VII Question 2.................... Section XIII, Question 70.
Section VIII. Notice of Special........ Section XV. Notice of special flood hazards and availability of Federal disaster relief.
Flood Hazards and Availability
of Federal Disaster Relief.
Section VIII, Question 1.................. Section XV, Question 73
Section VIII, Question 2.................. Section XV, Question 74.
Section VIII, Question 3.................. Section XV, Question 75.
Section VIII, Question 4.................. Section XV, Question 76.
Section VIII, Question 5.................. Section XV, Question 77.
Section VIII, Question 6.................. Section XV, Question 78.
Section IX. Notice of .... Section VIII. Flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights.
Servicer's Identity.
Section IX, Question 1.................... Section VIII, Question 45.
Section IX, Question 2.................... Section VIII, Question 46.
Section IX, Question 3.................... Section VIII, Question 47.
Section IX, Question 4.................... Section VIII, Question 48.
Section IX, Question 5.................... Section VIII, Question 49.
Section IX, Question 6.................... Section VIII, Question 50.
Section X Appendix A .... Section XV. Notice of special flood hazards and availability of Federal disaster relief.
to the Regulation-- Sample Form
of Notice of Special Flood
Hazards and Availability of Federal
Disaster Relief Assistance.
Section X, Question 1..................... Section XV, Question 80.

Proposed Questions and Answers and Request for Comment

The Agencies are proposing five new questions and answers for public [[Page 35932]] comment upon consideration of various comments received on the March 2008 Proposed Interagency Questions and Answers. The new proposed questions and answers concern the determination of insurable value in calculating the maximum limit of coverage available for the particular type of property under the Act and force placement of required flood insurance. In anticipation of the possible adoption of these proposed questions and answers, the applicable question and answer numbers have been reserved and the remaining questions and answers have been renumbered accordingly.

Insurable value. The Agencies received numerous comments to proposed question and answer 7 stating that implementing insurable value was confusing and that the term needed clear and objective standards. Commenters asked for guidance on the terms ``overall value'' and ``repair or replacement cost'' as they relate to a lender's determination of the required amount of flood insurance for a designated loan. Commenters similarly asked the Agencies to define the term ``actual cash value.'' In response to these comments, the Agencies are proposing new questions and answers 9 and 10 for public comment to address how to calculate insurable value. Calculating insurable value is important because in addition to

the maximum caps under the Act, the
Regulation provides that ``flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located." The Agencies use the term ``insurable value" in the proposed question and answer to mean the overall value minus the value of the land.

FEMA guidelines state that the full insurable value of a building is the same as 100 percent replacement cost value (RCV) of the insured building.\9\ Replacement cost value, according to FEMA's Mandatory Purchase of Flood Insurance Guidelines, is the cost to replace property with the same kind of material and construction without deduction for depreciation.\10\ As such, it is important to make clear that the RCV of a building is not its contributory value to the overall appraised value of the collateral and does not include any value for any land that is also part of collateral. When determining the RCV of a building, lenders (either by themselves or in consultation with the flood insurance provider or other professionals) should consider the
replacement cost value under a hazard insurance policy, an appraisal based on a cost-value before depreciation deductions (not a market-value) approach, and/or a construction cost calculation.

\9\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 27.
\10\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, at GLS10.

The statutory and regulatory requirement that flood insurance be obtained in the amount of the lesser of the principal balance of the designated loan or the maximum limit of coverage available for the particular type of building under the Act is separate from the amount of a recovery if the improved property is destroyed by flood. Insurable value is replacement cost value and would be the amount required for adequate insurance coverage assuming that amount does not exceed the principal balance of the designated loan or the maximum limit of coverage under the Act. Actual cash value, which would be determined by a claims adjuster at the time of loss, is the amount that will be paid by the NFIP for nonresidential properties and certain residential properties. To lessen the effect of a potential difference between the two values with certain nonresidential buildings, the Agencies, with FEMA's concurrence, are proposing new questions and answers 9 and 10.

It is important for lenders to recognize that insurable value is only relevant to the extent that it is lower than either the outstanding principal balance of the loan or the maximum amount of
insurance available under the NFIP. Therefore, if the insurable value of a building is the lesser of the outstanding principal balance of the loan or the maximum amount of insurance allowable under the NFIP, then the building must be insured at its insurable value, which for single family, 2-4 family, other residential or nonresidential buildings, is equivalent to its RCV. The Agencies are proposing new question and answer 9 to provide more concrete guidance on insurable value.

9. What is the insurable value of a building?

Answer: Per FEMA guidelines, the insurable value of a building is the same as 100 percent replacement cost value of the insured building. FEMA's Mandatory Purchase of Flood Insurance Guidelines defines replacement cost as ``The cost to replace property with the same kind of material and construction without deduction for depreciation." When determining replacement cost value of a building, lenders (either by themselves or in consultation with the flood insurance provider or other professionals) should consider the replacement cost value used in a hazard insurance policy (recognizing that replacement cost for flood insurance will include the foundation), an appraisal based on a cost-value approach before depreciation deductions (not a market-value), and/or a construction cost calculation.

In considering the comments submitted on the subject of insurable value, the Agencies recognized that there are situations when insuring some nonresidential buildings at RCV would result in the building being over-insured. The Agencies, in consultation with FEMA, are proposing two alternatives to determine replacement cost value for nonresidential buildings used for ranching, farming, or industrial purposes, which the borrower either would not replace if damaged or destroyed by a flood or would replace with a structure more closely aligned to the function the building is providing at the time of the flood. Industrial use, as opposed to the broader commercial use, is defined as those buildings not directly engaged in the retail and/or wholesale sale of the business's goods, such as warehouses or storage, manufacturing, or maintenance facilities.

The first alternative is the ``functional building cost value," which is the cost to repair or replace a building with commonly used, less costly construction materials and methods that are functionally equivalent to obsolete, antique, or custom construction materials and methods used in the original construction of the building. Borrowers and/or lenders can choose this alternative when the building being insured is important to the business operation and would be replaced if damaged or destroyed by a flood, but not to its original condition. The ``functional building cost value" recognizes that insurance to the replacement cost is not needed as the borrower would not repair or replace the building back to its original form but to a condition that represents the function the building is providing to the business operation.

The second alternative is the ``demolition/removal cost value," which is the cost to demolish the remaining structure and remove the debris after a flood. Borrowers and/or lenders can choose this alternative when the building being insured is not important to the business operation and would not be repaired or replaced if damaged or destroyed by a flood. The ``demolition/removal cost value" recognizes that the building has limited-to-no-value and [[Page 35933]] that it does not provide an important enough function to necessitate that the business repair or replace it.

When a borrower or lender chooses one of these two replacement cost value alternatives they have determined that the building to be insured will not be insured to its full replacement cost value. Both the borrower and the lender should ensure that they consider the impact this may have on the ongoing nature of the business and the value of the collateral securing the loan. Full replacement cost is always the preferred insurance amount. These alternatives are available only for those situations where full replacement cost would result in a building used for farming, ranching, or industrial purposes being over-insured. The Agencies are proposing new question and answer 10 to address this issue.

10. Are there alternative approaches to determining the insurable value of a building?

Answer: Yes, in the case of buildings used for ranching, farming, and industrial purposes, insurable value may also be determined by the functional building cost value or the demolition/removal cost value. The Agencies recognize that there are situations where insuring some nonresidential buildings to the replacement cost value will result in the building being over-insured. Therefore, borrowers and/or lenders have two alternative approaches to determine the insurable value for buildings used in ranching, farming, and for industrial purposes when the borrower would either not replace the building if damaged or destroyed by a flood or would replace the building with a structure more closely aligned with the function the building is presently providing. Industrial use, as opposed to the broader commercial use, means those buildings not directly engaged in the retail and/or wholesale sale of the business's goods, such as warehouses, storage, manufacturing, or maintenance facilities.

The lender may calculate the insurable value as the ``functional building cost value," that is, the cost to replace a building with a lower-cost functional equivalent. The ``functional building cost value" is the cost to repair or replace a building with commonly used, less costly construction materials and methods that are functionally equivalent to obsolete, antique, or custom construction materials and methods used in the original construction of the building. The determination of the appropriate ``functional building cost value" amount of insurance should be made by the lender and/or borrower. This alternative may be chosen when the building is important to the ongoing nature of the business and would be replaced if damaged or destroyed in a flood, but not to its original form. For example, a farming operation would replace an old dairy barn currently used for storage with a storage building of pole, or some other type of less costly construction found currently in storage buildings.

The lender may calculate the insurable value as the ``demolition/removal cost value," that is the cost to demolish the remaining structure and remove the debris. The ``demolition/removal cost value" may be used when a building is not important to the ongoing nature of the business and as such would not be replaced if damaged or destroyed by a flood. The amount of flood insurance should be calculated by the lender and/or borrower to be at least the cost of demolition and removal of the insured debris.

Regardless of what method the lender and/or borrower selects to determine insurable value (replacement cost value or one of the two alternatives), all terms and conditions of the Standard Flood Insurance Policy apply including its Loss Settlement provision.

Force placement. In response to comments received regarding the force placement of flood insurance, the Agencies are proposing new questions and answers 60, 61, and 62, which would be added to Section X to address the following force-placement issues: whether a borrower may be charged for the cost of flood insurance coverage during the 45-day notice period, when the 45-day notice period should begin, and how soon a lender should take action after learning that improved real estate that secures a loan is uninsured or under-insured.

Several commenters requested clarification regarding timing issues related to the 45-day notice. One commenter requested clarification on whether the 45-day notice could be sent prior to the actual date of expiration of flood insurance coverage. The Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider or as a result of an internal flood policy monitoring system. The borrower must obtain flood insurance within 45 days after notification by the lender; however, the 45-day period cannot begin until the lender or servicer has sent notice to the borrower. Furthermore, the Act does not permit a lender or its servicer to send the 45-day notice to the borrower prior to the actual expiration date of the flood insurance policy.

Another commenter suggested that flood insurance be force placed through private insurers since this would allow flood insurance coverage to be immediately available instead of having to wait 45 days. Whether the lender plans to force place coverage through FEMA or private insurers, lenders must allow the borrower 45 days in which to obtain flood insurance. The Agencies are proposing new question and answer 60 to address these commenters' issues.

60. Can the 45-day notice period be accelerated by sending notice to the borrower prior to the actual date of expiration of flood insurance coverage?

Answer: No. Although a lender or servicer may send a notice warning a borrower that flood insurance on the collateral is about to expire, the Act and Regulation do not allow a lender or its servicer to shorten the 45-day force-placement notice period by sending notice to the borrower prior to the actual expiration date of the flood insurance policy. The Act provides that a lender or its servicer must notify a borrower if it determines that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property. 42 U.S.C. 4012a(e). A lender must send the notice upon making a determination that the flood insurance coverage is inadequate or has expired, such as upon receipt of the notice of cancellation or expiration from the insurance provider or as a result of an internal flood policy monitoring system. This notice must allow the borrower 45 days in which to obtain flood insurance.

Three commenters asserted that it would be appropriate for the Agencies to allow a reasonable period to implement force placement after the end of the 45-day notice period. The Regulation provides that the lender or its servicer shall purchase insurance on the borrower's behalf if the borrower fails to obtain flood insurance within 45 days after notification. Given that the lender is already aware during the 45-day notice period that it may be required to force place insurance if there is no response from the borrower, any delay should be brief. Where there is a brief delay in force placing required insurance, the Agencies will expect the lender to provide a reasonable explanation for the delay. The Agencies [[Page 35934]] are proposing new question and answer 61 to address these commenters' concern.

One commenter suggested that a lender's procurement of the flood insurance binder should be acceptable under the Act and Regulation to satisfy the force placement requirement. The Agencies believe that the insurance binder may provide a reasonable explanation for a delay in force placing the formal flood insurance policy. However, an insurance binder is proof only of temporary coverage for a limited period of time until the formal insurance policy is either accepted or denied. Lenders should have sufficient internal controls in place to ensure that if a formal policy is not issued, it should force place required insurance immediately.

61. When must the lender have flood insurance in place if the borrower has not obtained adequate insurance within the 45-day notice period?

Answer: The Regulation provides that the lender or its servicer shall purchase insurance on the borrower's behalf if the borrower fails to obtain flood insurance within 45 days after notification. However, where there is a brief delay in force placing required insurance, the Agencies will expect the lender to provide a reasonable explanation for the delay.

Two commenters asked whether it is permissible to charge a borrower for the cost of insurance during all or a portion of the 45-day notice period. Regardless of whether the flood insurance coverage is obtained through FEMA or by private means, under the Act and Regulation, lenders may not impose the cost of coverage for that 45-day period at any time. The Agencies are proposing new question and answer 62 to address this comment.

62. Does a lender or its servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period?

Answer: No. There is no authority under the Act and Regulation to charge a borrower for a force-placed flood insurance policy until the 45-day notice period has expired. The ability to impose the costs of force placed flood insurance on a borrower commences 45 days after notification to the borrower of a lack of insurance or of inadequate insurance coverage. Therefore, lenders may not charge borrowers for coverage during the 45-day notice period. This holds true regardless of whether the force placed flood insurance is obtained through the NFIP or a private provider.

Public Comments

The Agencies specifically invite public comment on the proposed new questions and answers. If financial institutions, bank examiners, community groups, or other interested parties have unanswered questions or comments about the Agencies' flood insurance regulation, they should submit them to the Agencies. The Agencies will consider including these questions and answers in future guidance.

Solicitation of Comments Regarding the Use of ``Plain Language''

Section 722 of the Gramm-Leach-Bliley Act of 1999, 12 U.S.C. 4809, requires the Federal banking Agencies to use ``plain language'' in all proposed and final rules published after January 1, 2000. Although this document is not a proposed rule, comments are nevertheless invited on whether the proposed questions and answers are stated clearly and how they might be revised to be easier to read.

The text of the Interagency Questions and Answers follows:

Interagency Questions and Answers Regarding Flood Insurance

The Interagency Questions and Answers are organized by topic. Each topic addresses a major area of the Act and Regulation. For ease of reference, the following terms are used throughout this document: ``Act'' refers to 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 (codified at 42 U.S.C. 4001 et seq.). ``Regulation'' refers to each agency's current final rule.\11\ The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, ``the Agencies'') are providing answers to questions pertaining to the following topics:

\11\ The Agencies' rules are codified at 12 CFR part 22 (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (FDIC), 12 CFR part 572 (OTS), 12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA).

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I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance Is Required Under the Act and Regulation

1. Does the Regulation apply to a loan where the building or mobile home securing such loan is located in a community that does not participate in the National Flood Insurance Program (NFIP)?

Answer: Yes. The Regulation does apply; however, a lender need not require borrowers to obtain flood insurance for a building or mobile home located in a community that does not participate in the NFIP, even if the building or mobile home securing the loan is located in a Special Flood Hazard Area (SFHA). Nonetheless, a lender, using the standard Special Flood Hazard Determination Form (SFHDF), must still determine whether the building or mobile home is located in an SFHA. If the building or mobile home is determined to be located in an SFHA, a lender is required to notify the borrower. In this case, a lender, generally, may make a conventional loan without requiring flood insurance, if it chooses to do so. However, a lender may not make a government-guaranteed or insured loan, such as a Small Business Administration, Veterans Administration, or Federal Housing Administration loan secured by a building or mobile home located in an SFHA in a community that does not participate in the NFIP. See 42 U.S.C. 4106(a). Also, a lender is responsible for exercising sound risk management practices to ensure that it does not make a loan secured by a building or mobile home located in an SFHA where no flood insurance is available, if doing so would be an unacceptable risk.

2. What is a lender's responsibility if a particular building or mobile home that secures a loan, due to a map change, is no longer located within an SFHA?

Answer: The lender is no longer obligated to require mandatory flood insurance; however, the borrower can [[Page 35935]] elect to convert the existing NFIP policy to a Preferred Risk Policy. For risk management purposes, the lender may, by contract, continue to require flood insurance coverage.

3. Does a lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, from another lender trigger any requirements under the Regulation?

Answer: No. A lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, alone, is not an event that triggers the Regulation's requirements, such as making a new flood determination or requiring a borrower to purchase flood insurance. Requirements under the Regulation, generally, are triggered when a lender makes, increases, extends, or renews a designated loan. A lender's purchase of a loan does not fall within any of those categories.

However, if a lender becomes aware at any point during the life of a designated loan that flood insurance is required, the lender must comply with the Regulation, including force placing insurance, if necessary. Depending upon the circumstances, safety and soundness considerations may sometimes necessitate such due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. If the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the Regulation.

4. How do the Agencies enforce the mandatory purchase requirements under the Act and Regulation when a lender participates in a loan syndication or participation?

Answer: As with purchased loans, the acquisition by a lender of an interest in a loan either by participation or syndication after that loan has been made does not trigger the requirements of Act or Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. Nonetheless, as with purchased loans, depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake due diligence to protect itself against the risk of flood or other types of loss.

Lenders who pool or contribute funds that will be simultaneously advanced to a borrower or borrowers as a loan secured by improved real estate would all be subject to the requirements of Act or Regulation. Federal flood insurance requirements would also apply to those situations where such a group of lenders decides to extend, renew or increase a loan. Although the agreement among the lenders may assign compliance duties to a lead lender or agent, and include clauses in which the lead lender or agent indemnifies participating lenders against flood losses, each participating lender remains individually responsible for ensuring compliance with the Act and Regulation. Therefore, the Agencies will examine whether the regulated institution/participating lender 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 ongoing 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.

5. Does the Regulation apply to loans that are being restructured or modified?

Answer: It depends. If the loan otherwise meets the definition of a designated loan and if the lender increases the amount of the loan, or extends or renews the terms of the original loan, then the Regulation applies.

6. Are table funded loans treated as new loan originations?

Answer: Yes. Table funding, as defined under HUD's Real Estate Settlement Procedure Act (RESPA) rule, 24 CFR 3500.2, is a settlement at which a loan is funded by a contemporaneous advance of loan funds and the assignment of the loan to the person advancing the funds. A loan made through a table funding process is treated as though the party advancing the funds has originated the loan. The funding party is required to comply with the Regulation. The table funding lender can meet the administrative requirements of the Regulation by requiring the party processing and underwriting the application to perform those functions on its behalf.

7. Is a lender required to perform a review of its, or of its servicer's, existing loan portfolio for compliance with the flood insurance requirements under the Act and Regulation?

Answer: No. Apart from the requirements mandated when a loan is made, increased, extended, or renewed, 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 know of the need for NFIP coverage. Regardless of the lack of such requirement in the Act and Regulation, however, sound risk management practices may lead a lender to conduct scheduled periodic reviews that track the need for flood insurance on a loan portfolio.

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

8. The Regulation states that the amount of flood insurance required ``must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act." What is meant by the ``maximum limit of coverage available for the particular type of property under the Act"?

Answer: ``The maximum limit of coverage available for the particular type of property under the Act" depends on the value of the secured collateral. First, under the NFIP, there are maximum caps on the amount of insurance available. For single-family and two-to-four family dwellings and other residential buildings located in a participating community under the regular program, the maximum cap is $250,000. For nonresidential structures located in a participating community under the regular program, the maximum cap is $500,000. (In participating communities that are under the emergency program phase, the caps are $35,000 for single-family and two-to-four family dwellings and other residential structures, and $100,000 for nonresidential structures).

In addition to the maximum caps under the NFIP, the Regulation also provides that ``flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located," which is commonly referred to as the ``insurable value" of a structure. The NFIP does not insure land; therefore, land values should not be included in the calculation.

An NFIP policy will not cover an amount exceeding the ``insurable value" of the structure. In determining coverage amounts for flood insurance, lenders often follow the same practice used to establish other hazard insurance coverage amounts. However, unlike the insurable valuation used to underwrite most other hazard insurance policies, the insurable value of improved real
[[Page 35936]] estate for flood insurance purposes also includes the repair or replacement cost of the foundation and supporting structures. 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 estate, the borrower will be asked to purchase coverage that exceeds the amount the NFIP will pay in the event of a loss. (Please note, however, when taking a security interest in improved real estate where the value of the land, excluding the value of the improvements, is sufficient collateral for the debt, the lender must nonetheless require flood insurance to cover the value of the structure if it is located in a participating community's SFHA).

9. What is insurable value?

Answer: [Reserved]

10. Are there any alternatives to the definition of insurable value?

Answer: [Reserved]

11. What are examples of residential buildings?

Answer: Residential buildings include one-to-four family dwellings; apartment or other residential buildings containing more than four dwelling units; condominiums and cooperatives in which at least 75 percent of the square footage is residential; hotels or motels where the normal occupancy of a guest is six months or more; and rooming houses that have more than four roomers. A residential building may have incidental nonresidential use, such as an office or studio, as long as the total area of such incidental occupancy is limited to less than 25 percent of the square footage of the building, or 50 percent for single-family dwellings.

12. What are examples of nonresidential buildings?

Answer: Nonresidential buildings include those used for small businesses, churches, schools, farm activities (including grain bins and silos), pool houses, clubhouses, recreation, mercantile structures, agricultural and industrial structures, warehouses, hotels and motels with normal room rentals for less than six months' duration, nursing homes, and mixed-use buildings with less than 75 percent residential square footage.

13. How much insurance is required on a building located in an SFHA in a participating community?

Answer: 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.

Example: (Calculating insurance required on a nonresidential building):

Loan security includes one equipment shed located in an SFHA in a participating community under the regular program.

Outstanding loan principal is $300,000.

Maximum amount of insurance available under the NFIP:

Maximum limit available for type of structure is $500,000 per building (nonresidential building).

Insurable value of the equipment shed is $30,000.

The minimum amount of insurance required by the Regulation for the equipment shed is $30,000.

14. Is flood insurance required for each building when the real estate security contains more than one building located in an SFHA in a participating community? If so, how much coverage is required?

Answer: Yes. The lender must determine the amount of insurance required on each building and add these individual amounts together. The total amount of required flood insurance 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 structures; or

The ``insurable value'' of the structures.

The amount of total required flood insurance can be allocated among the secured buildings in varying amounts, but all buildings in an SFHA must have some coverage.

Example: Lender makes a loan in the principal amount of $150,000 secured by five nonresidential buildings, only three of which are located in SFHAs within participating communities.

Outstanding loan principal is $150,000.

Maximum amount of insurance available under the NFIP.

Maximum limit available for the type of structure is $500,000 per building (nonresidential buildings); or

Insurable value (for each nonresidential building for which insurance is required, which is $100,000, or $300,000 total).

Amount of insurance required for the three buildings is $150,000. This amount of required flood insurance could be allocated among the three buildings in varying amounts, so long as each is covered by flood insurance.

15. If the insurable value of a building or mobile home, located in an SFHA in which flood insurance is available under the Act, securing a designated loan is less than the outstanding principal balance of the loan, must a lender require the borrower to obtain flood insurance up to the balance of the loan?

Answer: No. The Regulation provides that the amount of flood insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for a particular type of property under the Act. The Regulation also provides that flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the building or mobile home is located. Since the NFIP policy does not cover land value, lenders should determine the amount of insurance necessary based on the insurable value of the improvements.

16. Can a lender require more flood insurance than the minimum required by the Regulation?

Answer: Yes. Lenders are permitted to require more flood insurance coverage than required by the Regulation. The borrower or lender may have to seek such coverage outside the NFIP. 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. However, lenders should avoid creating situations where a building is ``over-insured.''

17. Can a lender allow the borrower to use the maximum deductible to reduce the cost of flood insurance?

Answer: Yes. However, it is not a sound business practice for a lender to allow the borrower to use the maximum deductible amount in every situation. A lender should determine the reasonableness of the deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and lender. A lender may not allow the borrower to use a deductible amount equal to the insurable value of the property to avoid [[Page 35937]] the mandatory purchase requirement for flood insurance.

III. Exemptions From the Mandatory Flood Insurance Requirements

18. What are the exemptions from coverage?

Answer: There are only two exemptions from the purchase requirements. The first applies to State-owned property covered under a policy of self-insurance satisfactory to the Director of FEMA. The second applies if both the original principal balance of the loan is $5,000 or less, and the original repayment term is one year or less.

IV. Flood Insurance Requirements for Construction Loans

19. Is a loan secured only by land that is located in an SFHA in which flood insurance is available under the Act and that will be developed into buildable lot(s) a designated loan that requires flood insurance?

Answer: No. A designated loan is defined as a loan secured by a building or mobile home that is located or to be located in an SFHA in which flood insurance is available under the Act. Any loan secured only by land that is located in an SFHA in which flood insurance is available is not a designated loan since it is not secured by a building or mobile home.

20. Is a loan secured or to be secured by a building in the course of construction that is located or to be located in an SFHA in which flood insurance is available under the Act a designated loan?

Answer: Yes. Therefore, a lender must always make a flood determination prior to loan origination to determine whether a building to be constructed that is security for the loan is located or will be located in an SFHA in which flood insurance is available under the Act. If so, then the loan is a designated loan and the lender must provide the requisite notice to the borrower prior to loan origination that mandatory flood insurance is required. The lender must then comply with the mandatory purchase requirement under the Act and Regulation.

21. Is a building in the course of construction that is located in an SFHA in which flood insurance is available under the Act eligible for coverage under an NFIP policy?

Answer: Yes. FEMA's Flood Insurance Manual, under general rules, states:

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 Flood Elevation (BFE). Materials or supplies intended for use in such construction, alteration, or repair are not insurable unless they are contained within an enclosed building on the premises or adjacent to the premises.

FEMA, Flood Insurance Manual at p. GR 4 (FEMA's Flood Insurance Manual is updated every six months). The definition section of the Flood Insurance Manual defines ``start of construction'' in the case of new construction as ``either the first placement of permanent construction of a building on site, such as the pouring of a slab or footing, the installation of piles, the construction of columns, or any work beyond the stage of excavation; or the placement of a manufactured (mobile) home on a foundation.'' FEMA, Flood Insurance Manual, at p. DEF 9. 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 or when materials or supplies intended for use in such construction, alteration, or repair are contained in an enclosed building on the premises or adjacent to the premises.

22. When must a lender require the purchase of flood insurance for a loan secured by a building in the course of construction that is located in an SFHA in which flood insurance is available?

Answer: Under the Act, as implemented by the Regulation, a lender may not make, increase, extend, or renew any loan secured by a building or a mobile home, located or to be located in an SFHA in which flood insurance is available, unless the property is covered by adequate flood insurance for the term of the loan. One way for lenders to comply with the mandatory purchase requirement for a loan secured by a building in the course of construction that is located in an SFHA is to require borrowers to have a flood insurance policy in place at the time of loan origination.

Alternatively, a lender may allow a borrower to defer the purchase of flood insurance until either a foundation slab has been poured and/or an elevation certificate has been issued or, if the building to be constructed will have its lowest floor below the Base Flood Elevation, when the building is walled and roofed.\12\ However, the lender must require the borrower to have flood insurance in place before the lender disburses funds to pay for building construction (except as necessary to pour the slab or perform preliminary site work, such as laying utilities, clearing brush, or the purchase and/or delivery of building materials) on the property securing the loan. If the lender elects this approach and does not require flood insurance to be obtained at loan origination, then it must have adequate internal controls in place at origination to ensure that the borrower obtains flood insurance no later than when the foundation slab has been poured and/or an elevation
certificate has been issued.

\12\ FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 30.

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23. Does the 30-day waiting period apply when the purchase of the flood insurance policy is deferred in connection with a construction loan?

Answer: No. The NFIP will rely on an insurance agent's representation on the application for flood insurance that the purchase of insurance has been properly deferred unless there is a loss during the first 30 days of the policy period. In that case, the NFIP will require documentation of the loan transaction, such as settlement papers, before adjusting the loss.

V. Flood Insurance Requirements for Nonresidential Buildings

24. Some borrowers have buildings with limited utility or value and, in many cases, the borrower would not replace them if lost in a flood. Is a lender required to mandate flood insurance for such buildings?

Answer: Yes. Under the Regulation, lenders must require flood insurance on real estate improvements when those improvements are part of the property securing the loan and are located in an SFHA and in a participating community.

The lender may consider ``carving out'' buildings from the security it takes on the loan. However, the lender should fully analyze the risks of this option. In particular, a lender should consider whether it would be able to market the property securing its loan in the event of foreclosure. Additionally, the lender should consider any local zoning issues or other issues that would affect its collateral.

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25. What are a lender's requirements under the Regulation for a loan secured by multiple buildings located throughout a large geographic area where some of the buildings are located in an SFHA in which flood insurance is available and other buildings are not? What if the buildings are located in several jurisdictions or counties where some of the communities participate in the NFIP and others do not?

Answer: A lender is required to make a determination as to whether the improved real property securing the loan is in an SFHA. If secured improved real estate is located in an SFHA, but not in a participating community, no flood insurance is required, although a lender can require the purchase of flood insurance (from a private insurer) as a matter of safety and soundness. Conversely, where secured improved real estate is located in a participating community but not in an SFHA, no insurance is required. A lender must provide appropriate notice and require the purchase of flood insurance for designated loans located in an SFHA in a participating community.

VI. Flood Insurance Requirements for Residential Condominiums

26. Are residential condominiums, including multi-story condominium complexes, subject to the statutory and regulatory requirements for flood insurance?

Answer: Yes. The mandatory flood insurance purchase requirements under the Act and Regulation apply to loans secured by individual residential condominium units, including those located in multi-story condominium complexes, located in an SFHA in which flood insurance is available under the Act. The mandatory purchase requirements also apply to loans secured by other condominium property, such as loans to a developer for construction of the condominium or loans to a condominium association.

27. What is an NFIP Residential Condominium Building Association Policy (RCBAP)?

Answer: The RCBAP is a master policy for residential condominiums issued by FEMA. A residential condominium building is defined as having 75 percent or more of the building's floor area in residential use. It may be purchased only by condominium owners associations. The RCBAP covers both the common and individually owned building elements within the units, improvements within the units, and contents owned in common (if contents coverage is purchased). The maximum amount of building coverage that can be purchased under an RCBAP is either 100 percent of the replacement cost value of the building, including amounts to repair or replace the foundation and its supporting structures, or the total number of units in the condominium building times $250,000, whichever is less. RCBAP coverage is available only for residential condominium buildings in Regular Program communities.

28. What is the amount of flood insurance coverage that a lender must require with respect to residential condominium units, including those located in multi-story condominium complexes, to comply with the mandatory purchase requirements under the Act and the Regulation?

Answer: To comply with the Regulation, the lender must ensure that the minimum amount of flood insurance covering the condominium unit 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 residential condominium unit; or

The ``insurable value" allocated to the residential condominium unit, which is the replacement cost value of the condominium building divided by the number of units.

Effective October 1, 2007, FEMA required agents to provide on the declaration page of the RCBAP the replacement cost value of the condominium building and the number of units. Lenders may rely on the replacement cost value and number of units on the RCBAP declaration page in determining insurable value unless they have reason to believe that such amounts clearly conflict with other available information. If there is a conflict, the lender should notify the borrower of the facts that cause the lender to believe there is a conflict. If the lender believes that the borrower is underinsured, it should require the purchase of a Dwelling Policy for supplemental coverage.

Assuming that the outstanding principal balance of the loan is greater than the maximum amount of coverage available under the NFIP, the lender must require a borrower whose loan is secured by a residential condominium unit to either:

Ensure the condominium owners association has purchased an NFIP Residential Condominium Building Association Policy (RCBAP) covering either 100 percent of the insurable value (replacement cost) of the building, including amounts to repair or replace the foundation and its supporting structures, or the total number of units in the condominium building times $250,000, whichever is less; or

Obtain a dwelling policy if there is no RCBAP, as explained in question and answer 29, or if the RCBAP coverage is less than 100 percent of the replacement cost value of the building or the total number of units in the condominium building times $250,000, whichever is less, as explained in question and answer 30.

Example: Lender makes a loan in the principal amount of $300,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost of $15 million and insured by an RCBAP with $12.5 million of coverage.

Outstanding principal balance of loan is $300,000.

Maximum amount of coverage available under the NFIP, which is the lesser of:

Maximum limit available for the residential condominium unit is $250,000; or

Insurable value of the unit based on 100 percent of the building's replacement cost value ($15 million / 50 = $300,000).

The lender does not need to require additional flood insurance since the RCBAP's $250,000 per unit coverage ($12.5 million / 50 = $250,000) satisfies the Regulation's mandatory flood insurance requirement. (This is the lesser of the outstanding principal balance ($300,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($300,000)).

The guidance in this question and answer will apply to any loan that is made, increased, extended, or renewed after the effective date of this revised guidance. This revised guidance will not apply to any loans made prior to the effective date of this guidance until a trigger event occurs (that is, the loan is refinanced, extended, increased, or renewed) in connection with the loan. Absent a new trigger event, loans made prior to the effective date of this new guidance will be considered compliant if they complied with the Agencies' previous guidance, which stated that an RCBAP that provided 80 percent RCV coverage was sufficient.

29. What action must a lender take if there is no RCBAP coverage?

Answer: If there is no RCBAP, either because the condominium association will not obtain a policy or because individual unit owners are responsible for obtaining their own insurance, then the lender must require the individual unit owner/borrower to obtain a dwelling policy in an amount sufficient to meet the requirements outlined in Question 28.

A dwelling policy is available for condominium unit owners' purchase when there is no or inadequate RCBAP [[Page 35939]] coverage. When coverage by an RCBAP is inadequate, the dwelling policy may provide individual unit owners with supplemental building coverage to the RCBAP. The RCBAP and the dwelling policy are coordinated such that the dwelling policy purchased by the unit owner responds to shortfalls on building coverage pertaining either to improvements owned by the insured unit owner or to assessments. However, the dwelling policy does not extend the RCBAP limits, nor does it enable the condominium association to fill in gaps in coverage.

Example: The lender makes a loan in the principal amount of $175,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost value of $10 million; however, there is no RCBAP.

Outstanding principal balance of loan is $175,000.

Maximum amount of coverage available under the NFIP, which is the lesser of:

Maximum limit available for the residential condominium unit is $250,000; or

Insurable value of the unit based on 100 percent of the building's replacement cost value ($10 million / 50 = $200,000).

The lender must require the individual unit owner/borrower to purchase a flood insurance dwelling policy in the amount of at least $175,000, since there is no RCBAP, to satisfy the Regulation's mandatory flood insurance requirement. (This is the lesser of the outstanding principal balance ($175,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($200,000).)

30. What action must a lender take if the RCBAP coverage is insufficient to meet the Regulation's mandatory purchase requirements for a loan secured by an individual residential condominium unit?

Answer: If the lender determines that flood insurance coverage purchased under the RCBAP is insufficient to meet the Regulation's mandatory purchase requirements, then the lender should request that the individual unit owner/borrower ask the condominium association to obtain additional coverage that would be sufficient to meet the Regulation's requirements (see question and answer 28). If the condominium association does not obtain sufficient coverage, then the lender must require the individual unit owner/borrower to purchase a dwelling policy in an amount sufficient to meet the Regulation's flood insurance requirements. The amount of coverage under the dwelling policy required to be purchased by the individual unit owner would be the difference between the RCBAP's coverage allocated to that unit and the Regulation's mandatory flood insurance requirements (see question and answer 29).

Example: Lender makes a loan in the principal amount of $300,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost value of $10 million; however, the RCBAP is at 80 percent of replacement cost value ($8 million or $160,000 per unit).

Outstanding principal balance of loan is $300,000.

Maximum amount of coverage available under the NFIP, which is the lesser of:

Maximum limit available for the residential condominium unit is $250,000; or

Insurable value of the unit based on 100 percent of the building's replacement value ($10 million / 50 = $200,000).

The lender must require the individual unit owner/borrower to purchase a flood insurance dwelling policy in the amount of $40,000 to satisfy the Regulation's mandatory flood insurance requirement of $200,000. (This is the lesser of the outstanding principal balance ($300,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($200,000).) The RCBAP fulfills only $160,000 of the Regulation's flood insurance requirement.

While the individual unit owner's purchase of a separate dwelling policy that provides for adequate flood insurance coverage under the Regulation will satisfy the Regulation's mandatory flood insurance requirements, the lender and the individual unit owner/borrower may still be exposed to additional risk of loss. Lenders are encouraged to apprise borrowers of this risk. The dwelling policy provides individual unit owners with supplemental building coverage to the RCBAP. The policies are coordinated such that the dwelling policy purchased by the unit owner responds to shortfalls on building coverage pertaining either to improvements owned by the insured unit owner or to assessments. However, the dwelling policy does not extend the RCBAP limits, nor does it enable the condominium association to fill in gaps in coverage.

The risk arises because the individual unit owner's dwelling policy may contain claim limitations that prevent the dwelling policy from covering the individual unit owner's share of the co-insurance penalty, which is triggered when the amount of insurance under the RCBAP is less than 80 percent of the building's replacement cost value at the time of loss. In addition, following a major flood loss, the insured unit owner may have to rely upon the condominium association's and other unit owners' financial ability to make the necessary repairs to common elements in the building, such as electricity, heating, plumbing, and elevators. It is incumbent on the lender to understand these limitations.

31. What must a lender do when a loan secured by a residential condominium unit is in a complex whose condominium association allows its existing RCBAP to lapse?

Answer: 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 that required under the Act and the Regulation, the lender must notify the individual unit owner/borrower of the requirement to maintain flood insurance coverage sufficient to meet the Regulation's mandatory requirements. The lender should encourage the individual unit owner/borrower to work with the condominium association to acquire a new RCBAP in an amount sufficient to meet the Regulation's mandatory flood insurance requirement (see question and answer 28). Failing that, the lender must require the individual unit owner/borrower to obtain a flood insurance dwelling policy in an amount sufficient to meet the Regulation's mandatory flood insurance requirement (see questions and answers 29 and 30). If the borrower/unit owner or the condominium association fails to purchase flood insurance sufficient to meet the Regulation's mandatory requirements within 45 days of the lender's notification to the individual unit owner/borrower of inadequate insurance coverage, the lender must force place the necessary flood insurance.

32. How does the RCBAP's co-insurance penalty apply in the case of residential condominiums, including those located in multi-story condominium complexes?

Answer: In the event the RCBAP's coverage on a condominium building at the time of loss is less than 80 percent of either the building's replacement cost or the maximum amount of insurance available for that building under the NFIP (whichever is less), then the loss payment, which is subject to a co-insurance penalty, is determined as follows (subject to all other relevant conditions in this policy, including those pertaining to valuation, adjustment, settlement, and payment of loss):

A. Divide the actual amount of flood insurance carried on the condominium building at the time of loss by 80 percent of either its replacement cost or the maximum amount of insurance
[[Page 35940]] available for the building under the NFIP, whichever is less.

B. Multiply the amount of loss, before application of the deductible, by the figure determined in A above.

C. Subtract the deductible from the figure determined in B above.

The policy will pay the amount determined in C above, or the amount of insurance carried, whichever is less.

Example 1: (Inadequate insurance amount to avoid penalty).

Replacement value of the building: $250,000.

80% of replacement value of the building: $200,000.

Actual amount of insurance carried: $180,000.

Amount of the loss: $150,000.

Deductible: $ 500.

Step A: 180,000 / 200,000 = .90 (90% of what should be carried to avoid co-insurance penalty)

Step B: 150,000 x .90 = 135,000

Step C: 135,000 - 500 = 134,500

The policy will pay no more than $134,500. The remaining $15,500 is not covered due to the co-insurance penalty ($15,000) and application of the deductible ($500). Unit owners' dwelling policies will not cover any assessment that may be imposed to cover the costs of repair that are not covered by the RCBAP.

Example 2: (Adequate insurance amount to avoid penalty).

Replacement value of the building: $250,000.

80% of replacement value of the building: $200,000.

Actual amount of insurance carried: $200,000.

Amount of the loss: $150,000.

Deductible: $ 500.

Step A: 200,000 / 200,000 = 1.00 (100% of what should be carried to avoid co-insurance penalty)

Step B: 150,000 x 1.00 = 150,000

Step C: 150,000 - 500 = 149,500

In this example there is no co-insurance penalty, because the actual amount of insurance carried meets the 80 percent requirement to avoid the co-insurance penalty. The policy will pay no more than $149,500 ($150,000 amount of loss minus the $500 deductible). This example also assumes a $150,000 outstanding principal loan balance.

33. What are the major factors involved with the individual unit owner's dwelling policy's coverage limitations with respect to the condominium association's RCBAP coverage?

Answer: The following examples demonstrate how the unit owner's dwelling policy may cover in certain loss situations:

Example 1: (RCBAP insured to at least 80 percent of building replacement cost).

If the unit owner purchases building coverage under the dwelling policy and if there is an RCBAP covering at least 80 percent of the building replacement cost value, the loss assessment coverage under the dwelling policy will pay that part of a loss that exceeds 80 percent of the association's building replacement cost allocated to that unit.

The loss assessment coverage under the dwelling policy will not cover the association's policy deductible purchased by the condominium association.

If building elements within units have also been damaged, the dwelling policy pays to repair building elements after the RCBAP limits that apply to the unit have been exhausted. Coverage combinations cannot exceed the total limit of $250,000 per unit.

Example 2: (RCBAP insured to less than 80 percent of building replacement cost).

If the unit owner purchases building coverage under the dwelling policy and there is an RCBAP that was insured to less than 80 percent of the building replacement cost value at the time of loss, the loss assessment coverage cannot be used to reimburse the association for its co-insurance penalty.

Loss assessment is available only to cover the building damages in excess of the 80-percent required amount at the time of loss. Thus, the covered damages to the condominium association building must be greater than 80 percent of the building replacement cost value at the time of loss before the loss assessment coverage under the dwelling policy becomes available. Under the dwelling policy, covered repairs to the unit, if applicable, would have priority in payment over loss assessments against the unit owner.

Example 3: (No RCBAP),

If the unit owner purchases building coverage under the dwelling policy and there is no RCBAP, the dwelling policy covers assessments against unit owners for damages to common areas up to the dwelling policy limit.

However, if there is damage to the building elements of the unit as well, the combined payment of unit building damages, which would apply first, and the loss assessment may not exceed the building coverage limit under the dwelling policy.

VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA

34. Is a home equity loan considered a designated loan that requires flood insurance?

Answer: Yes. A home equity loan is a designated loan, regardless of the lien priority, if the loan is secured by a building or a mobile home located in an SFHA in which flood insurance is available under the Act.

35. Does a draw against an approved line of credit secured by a building or mobile home, which is located in an SFHA in which flood insurance is available under the Act, require a flood determination under the Regulation?

Answer: No. While a line of credit secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act is a designated loan and, therefore, requires a flood determination before the loan is made, draws against an approved line do not require further determinations. However, a request made for an increase in an approved line of credit may require a new determination, depending upon whether a previous determination was done. (See response to question 68 in Section XIII. Required use of Standard Flood Hazard Determination Form.)

36. When a lender makes, increases, extends or renews a second mortgage secured by a building or mobile home located in an SFHA, how much flood insurance must the lender require?

Answer: The lender must ensure that adequate flood insurance is in place or require that additional flood insurance coverage be added to the flood insurance policy 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 Act (currently $250,000 for a residential building and $500,000 for a nonresidential building), or the insurable value of the building or mobile home. The junior lienholder should also ensure that the borrower adds the junior lienholder's name as mortgagee/loss payee to the existing flood insurance policy. Given the provisions of NFIP policies, a lender cannot comply with the Act and Regulation by requiring the purchase of an NFIP flood insurance policy 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.

A junior lienholder should work with the senior lienholder, the borrower, or with both of these parties, to determine how much flood insurance is needed to cover improved real estate collateral. A junior lienholder should obtain the borrower's consent in the loan agreement or otherwise for the junior lienholder to obtain information on balance and existing flood insurance coverage on senior lien loans from the senior lienholder.

Junior lienholders also have the option of pulling a borrower's credit report and using the information from that document to establish how much flood insurance is necessary upon increasing, extending or renewing a junior lien, thus protecting the interests of the junior lienholder, the senior lienholders, and the borrower. In the limited situation where a junior lienholder or its servicer is unable to [[Page 35941]] obtain the necessary information about the amount of flood insurance in place on the outstanding balance of a senior lien (for example, in the context of a loan renewal), the lender may presume that the amount of insurance coverage relating to the senior lien in place at the time the junior lien was first established (provided that the amount of flood insurance relating to the senior lien was adequate at the time) continues to be sufficient.

Example 1: Lender A makes a first mortgage with a principal balance of $100,000, but improperly requires only $75,000 of flood insurance coverage, which the borrower satisfied by obtaining an NFIP policy. Lender B issues a second mortgage with a principal balance of $50,000. The insurable value of the residential building securing the loans is $200,000. Lender B must ensure that flood insurance in the amount of $150,000 is purchased and maintained. If Lender B were to require additional flood insurance only in an amount equal to the principal balance of the second mortgage ($50,000), its interest in the secured property would not be fully protected in the event of a flood loss because Lender A would have prior claim on $100,000 of the loss payment towards its principal balance of $100,000, while Lender B would receive only $25,000 of the loss payment toward its principal balance of $50,000.

Example 2: Lender A, who is not directly covered by the Act or Regulation, makes a first mortgage with a principal balance of $100,000 and does not require flood insurance. Lender B, who is directly covered by the Act and Regulation, issues a second mortgage with a principal balance of $50,000. The insurable value of the residential building securing the loans is $200,000. Lender B must ensure that flood insurance in the amount of $150,000 is purchased and maintained. If Lender B were to require flood insurance only in an amount equal to the principal balance of the second mortgage ($50,000) through an NFIP policy, then its interest in the secured property would not be protected in the event of a flood loss because Lender A would have prior claim on the entire $50,000 loss payment towards its principal balance of $100,000.

Example 3: Lender A made a first mortgage with a principal balance of $100,000 on improved real estate with a fair market value of $150,000. The insurable value of the residential building on the improved real estate is $90,000; however, Lender A improperly required only $70,000 of flood insurance coverage, which the borrower satisfied by purchasing an NFIP policy. Lender B later takes a second mortgage on the property with a principal balance of $10,000. Lender B must ensure that flood insurance in the amount of $90,000 (the insurable value) is purchased and maintained on the secured property to comply with the Act and Regulation. If Lender B were to require flood insurance only in an amount equal to the principal balance of the second mortgage ($10,000), its interest in the secured property would not be protected in the event of a flood loss because Lender A would have prior claim on the entire $70,000 loss payment towards the insurable value of $90,000.

37. If a borrower requesting a loan secured by a junior lien provides evidence that flood insurance coverage is in place, does the lender have to make a new determination? Does the lender have to adjust

the insurance coverage?

Answer: It depends. Assuming the requirements in Section 528 of the Act (42 U.S.C. 4104b) are met and the same lender made the first mortgage, then a new determination may not be necessary, when the existing determination is not more than seven years old, there have been no map changes, and the determination was recorded on an SFHDF. If, however, a lender other than the one that made the first mortgage loan is making the junior lien loan, a new determination would be required because this lender would be deemed to be ``making'' a new loan. In either situation, the lender will need to determine whether the amount of insurance in force is sufficient to cover the lesser of the combined outstanding principal balance of all loans (including the junior lien loan), the insurable value, or the maximum amount of coverage available on the improved real estate. This will hold true whether the subordinate lien loan is a home equity loan or some other type of junior lien loan.

38. If the loan request is to finance inventory stored in a building located within an SFHA, but the building is not security for the loan, is flood insurance required?

Answer: No. The Act and the Regulation provide that a lender shall not make, increase, extend, or renew a designated loan, that is a loan secured by a building or mobile home located or to be located in an SFHA, ``unless the building or mobile home and any personal property securing such loan'' is covered by flood insurance for the term of the loan. In this example, the collateral is not the type that could secure a designated loan because it does not include a building or mobile home; rather, the collateral is the inventory alone.

39. 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.

Example: Lender A makes a loan for $200,000 that is secured by a warehouse with an insurable value of $150,000 and inventory in the warehouse worth $100,000. The Act and Regulation require that flood insurance coverage be obtained for the lesser of the outstanding principal balance of the loan or the maximum amount of flood insurance that is available under the NFIP. The maximum amount of insurance that is available for both building and contents is $500,000 for each category. In this situation, Federal flood insurance requirements could be satisfied by placing $150,000 worth of flood insurance coverage on the warehouse, thus insuring it to its insurable value, and $50,000 worth of contents flood insurance coverage on the inventory, thus providing total coverage in the amount of the outstanding principal balance of the loan. Note that this holds true even though the inventory is worth $200,000.

40. If a loan is secured by Building A, which is located in an SFHA, and contents, which are located in Building B, is flood insurance required on the contents securing a loan?

Answer: No. If collateral securing the loan is stored in Building B, which does not secure the loan, then flood insurance is not required on those contents whether or not Building B is located in an SFHA.

41. Does the Regulation apply where the lender takes a security interest in a building or mobile home located in an SFHA only as an ``abundance of caution''?

Answer: Yes. The Act and Regulation look to the collateral securing the loan. If the lender takes a security interest in improved real estate located in an SFHA, then flood insurance is required.

42. If a borrower offers a note on a single-family dwelling as collateral for a loan but the lender does not take a security interest in the dwelling itself, is this a designated loan that requires flood insurance?

Answer: No. A designated loan is a loan secured by a building or mobile home. In this example, the lender did not take a security interest in the building; therefore, the loan is not a designated loan.

43. If a lender makes a loan that is not secured by real estate, but is made on the condition of a personal guarantee by a third party who gives the lender a security interest in improved real estate owned by the third party that is located in an SFHA in which flood insurance is available, is it a designated loan that requires flood insurance?

Answer: Yes. The making of a loan on condition of a personal guarantee by a third party and further secured by improved real estate, which is located in [[Page 35942]] an SFHA, owned by that third party is so closely tied to the making of the loan that it is considered a designated loan that requires flood insurance.

VIII. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or Its Servicing Rights

44. How do the flood insurance requirements under the Regulation apply to regulated lenders under the following scenarios involving loan servicing?

Scenario 1: A regulated lender originates a designated loan secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act. The regulated lender makes the initial flood determination, provides the borrower with appropriate notice, and flood insurance is obtained. The regulated lender initially services the loan; however, the regulated lender subsequently sells both the loan and the servicing rights to a nonregulated party. What are the regulated lender's requirements under the Regulation? What are the regulated lender's requirements under the Regulation if it only transfers or sells the servicing rights, but retains ownership of the loan?

Answer: The regulated lender must comply with all requirements of the Regulation, including making the initial flood determination, providing appropriate notice to the borrower, and ensuring that the proper amount of insurance is obtained. In the event the regulated lender sells or transfers the loan and servicing rights, the regulated lender must provide notice of the identity of the new servicer to FEMA or its designee. Once the regulated lender has sold the loan and the servicing rights, the lender has no further obligation regarding flood insurance on the loan.

If the regulated lender retains ownership of the loan and only transfers or sells the servicing rights to a nonregulated party, the regulated lender must notify FEMA or its designee of the identity of the new servicer. The servicing contract should require the servicer to comply with all the requirements that are imposed on the regulated lender as owner of the loan, including escrow of insurance premiums and force placement of insurance, if necessary.

Generally, the Regulation does not impose obligations on a loan servicer independent from the obligations it imposes on the owner of a loan. Loan servicers are covered by the escrow, force placement, and flood hazard determination fee provisions of the Act and Regulation primarily so that they may perform the administrative tasks for the regulated lender, without fear of liability to the borrower for the imposition of unauthorized charges. It is the Agencies' longstanding position, as described in the preamble to the Regulation that the obligation of a loan servicer to fulfill administrative duties with respect to the flood insurance requirements arises from the contractual relationship between the loan servicer and the regulated lender or from other commonly accepted standards for performance of servicing obligations. The regulated lender remains ultimately liable for fulfillment of those responsibilities, and must take adequate steps to ensure that the loan servicer will maintain compliance with the flood insurance requirements.

Scenario 2: A nonregulated lender originates a designated loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act. The nonregulated lender does not make an initial flood determination or notify the borrower of the need to obtain insurance. The nonregulated lender sells the loan and servicing rights to a regulated lender. What are the regulated lender's requirements under the Regulation? What are the regulated lender's requirements if it only purchases the servicing rights?

Answer: A regulated lender's purchase of a loan and servicing rights, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, is not an event that triggers any requirements under the Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. The Regulation's requirements are triggered when a regulated lender makes, increases, extends, or renews a designated loan. A regulated lender's purchase of a loan does not fall within any of those categories. However, if a regulated lender becomes aware at any point during the life of a designated loan that flood insurance is required, then the regulated lender must comply with the Regulation, including force placing insurance, if necessary. Depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake sufficient due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. If the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the
Act and Regulation.

Where a regulated lender purchases only the servicing rights to a loan originated by a nonregulated lender, the regulated lender is obligated only to follow the terms of its servicing contract with the owner of the loan. In the event the regulated lender subsequently sells or transfers the servicing rights on that loan, the regulated lender must notify FEMA or its designee of the identity of the new servicer, if required to do so by the servicing contract with the owner of the loan.

45. When a regulated lender makes a designated loan and will be servicing that loan, what are the requirements for notifying the Director of FEMA or the Director's designee?

Answer: FEMA stated in a June 4, 1996, letter that the Director's designee is the insurance company issuing the flood insurance policy. The borrower's purchase of a policy (or the regulated lender's force placement of a policy) will constitute notice to FEMA when the regulated lender is servicing that loan.

In the event the servicing is subsequently transferred to a new servicer, the regulated lender must provide notice to the insurance company of the identity of the new servicer no later than 60 days after the effective date of such a change.

46. Would a RESPA Notice of Transfer sent to the Director of FEMA (or the Director's designee) satisfy the regulatory provisions of the Act?

Answer: Yes. The delivery of a copy of the Notice of Transfer or any other form of notice is sufficient if the sender includes, on or with the notice, the following information that FEMA has indicated is needed by its designee:

Borrower's full name;

Flood insurance policy number;

Property address (including city and State);

Name of lender or servicer making notification;

Name and address of new servicer; and

Name and telephone number of contact person at new servicer.

47. Can delivery of the notice be made electronically, including batch transmissions?

Answer: Yes. The Regulation specifically permits transmission by electronic means. A timely batch transmission of the notice would also be permissible, if it is acceptable to the Director's designee.

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48. If the loan and its servicing rights are sold by the regulated lender, is the regulated lender required to provide notice to the Director or the Director's designee?

Answer: Yes. Failure to provide such notice would defeat the purpose of the notice requirement because FEMA would have no record of the identity of either the owner or servicer of the loan.

49. Is a regulated lender required to provide notice when the servicer, not the regulated lender, sells or transfers the servicing rights to another servicer?

Answer: No. After servicing rights are sold or transferred, subsequent notification obligations are the responsibility of the new servicer. The obligation of the regulated lender to notify the Director or the Director's designee of the identity of the servicer transfers to the new servicer. The duty to notify the Director or the Director's designee of any subsequent sale or transfer of the servicing rights and responsibilities belongs to that servicer. For example, a financial institution makes and services the loan. It then sells the loan in the secondary market and also sells the servicing rights to a mortgage company. The financial institution notifies the Director's designee of the identity of the new servicer and the other information requested by FEMA so that flood insurance transactions can be properly administered by the Director's designee. If the mortgage company later sells the servicing rights to another firm, the mortgage company, not the financial institution, is responsible for notifying the Director's designee of the identity of the new servicer.

50. In the event of a merger or acquisition of one lending institution with another, what are the responsibilities of the parties for notifying the Director's designee?

Answer: If an institution is acquired by or merges with another institution, the duty to provide notice for the loans being serviced by the acquired institution will fall to the successor institution in the event that notification is not provided by the acquired institution prior to the effective date of the acquisition or merger.

IX. Escrow Requirements

51. Are multi-family buildings or mixed-use properties included in the definition of ``residential improved real estate'' under the Regulation for which escrows are required?

Answer: ``Residential improved real estate'' is defined under the Regulation as ``real estate upon which a home or other residential building is located or to be located.'' A loan secured by residential improved real estate located or to be located in an SFHA in which flood insurance is available is a designated loan. Lenders are required to escrow flood insurance premiums and fees for mandatory flood insurance for such loans if the lender requires the escrow of taxes, hazard insurance premiums or any other charges for loans secured by residential improved real estate. A lender is not required to escrow flood insurance premiums and fees for a particular loan if it does not require escrowing of any other charges for that loan.

Multi-family buildings. For the purposes of the Act and the Regulation, the definition of residential improved real estate does not make a distinction between whether a building is single- or multi-family, or whether a building is owner- or renter-occupied. Single-family dwellings (including mobile homes), two-to-four family dwellings, and multi-family properties containing five or more residential units are covered under the Act's escrow provisions. If the building securing the loan meets the Regulation's definition of residential improved real estate and the lender requires the escrow of any other charges such as taxes or hazard insurance premiums, then the lender is required to also escrow premiums and fees for flood insurance.

Mixed-use properties. The lender should look to the primary use of a building to determine whether it meets the definition of ``residential improved real estate.'' (See questions and answers 11 and 12 for guidance on residential and nonresidential buildings.) If the primary use of a mixed-use property is for residential purposes, the Regulation's escrow requirements apply.

52. When must escrow accounts be established for flood insurance purposes?

Answer: If a lender requires the escrow of taxes, insurance premiums, fees, or any other charges for a loan secured by residential improved real estate or a mobile home, the lender must also require the escrow of all flood insurance premiums and fees. When administering loans secured by one-to-four family dwellings, lenders should look to the definition of ``Federally related mortgage loan'' contained in the Real Estate Settlement Procedures Act (RESPA) to see whether a particular loan is subject to the escrow requirements in Section 10 of RESPA. (This includes individual units of condominiums. Individual units of cooperatives, although covered by Section 10 of RESPA, are not insurable under the NFIP and are not covered by the Regulation.) Loans on multi-family dwellings with five or more units are not covered by RESPA requirements. Pursuant to the Regulation, however, lenders must escrow premiums and fees for any required flood insurance if the lender requires escrows for other purposes, such as hazard insurance or taxes.

53. Do voluntary escrow accounts established at the request of the borrower trigger a requirement for the lender to escrow premiums for required flood insurance?

Answer: No. If escrow accounts for other purposes are established at the voluntary request of the borrower, the lender is not required to establish escrow accounts for flood insurance premiums. Examiners should review the loan policies of the lender and the underlying legal obligation between the parties to the loan to determine whether the accounts are, in fact, voluntary. For example, when a lender's loan policies require borrowers to establish escrow accounts for other purposes and the contractual obligation permits the lender to establish escrow accounts for those other purposes, the lender will have the burden of demonstrating that an existing escrow was made pursuant to a voluntary request by the borrower.

54. Will premiums paid for credit life insurance, disability insurance, or similar insurance programs be viewed as escrow accounts requiring the escrow of flood insurance premiums?

Answer: No. Premiums paid for these types of insurance policies will not trigger the escrow requirement for flood insurance premiums.

55. Will escrow-type accounts for commercial loans, secured by multi-family residential buildings, trigger the escrow requirement for flood insurance premiums?

Answer: It depends. Escrow-type accounts established in connection with the underlying agreement between the buyer and seller, or that relate to the commercial venture itself, such as ``interest reserve accounts,'' ``compensating balance accounts,'' ``marketing accounts,'' and similar accounts are not the type of accounts that constitute escrow accounts for the purpose of the Regulation. However, escrow accounts established for the protection of the property, such as escrows for hazard insurance premiums or local real estate taxes, are the types of escrow accounts that trigger the [[Page 35944]] requirement to escrow flood insurance premiums.

56. Which requirements for escrow accounts apply to properties adequately covered by RCBAPs?

Answer: RCBAPs (Residential Condominium Building Association Policies) are policies purchased by the condominium association on behalf of itself and the individual unit owners in the condominium. A portion of the periodic dues paid to the association by the condominium owners applies to the premiums on the policy. When a lender makes, increases, renews, or extends a loan secured by a condominium unit that is adequately covered by an RCBAP and dues to the condominium association apply to the RCBAP premiums, an escrow account is not required. However, if the RCBAP coverage is inadequate and the unit is also covered by a dwelling form policy, premiums for the dwelling form policy would need to be escrowed if the lender requires escrow for
other purposes, such as hazard insurance or taxes. Lenders should exercise due diligence with respect to continuing compliance with the insurance requirements on the part of the condominium association.

X. Force Placement of Flood Insurance

57. What is the requirement for the force placement of flood insurance under the Act and Regulation?

Answer: The Act and Regulation require a lender to force place flood insurance, if all of the following circumstances occur:

The lender determines at any time during the life of the loan that the property securing the loan is located in an SFHA;

Flood insurance under the Act is available for improved property securing the loan;

The lender determines that flood insurance coverage is inadequate or does not exist; and

After required notice, the borrower fails to purchase the appropriate amount of coverage.

The Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider. The notice to the borrower must also state that if the borrower does not obtain the insurance within the 45-day period, the lender will purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees to obtain the coverage. The Act does not permit a lender or its servicer to send the required 45-day notice to the borrower prior to making a determination that flood insurance coverage is inadequate. If adequate insurance is not obtained by the borrower within the 45-day notice period, then the lender must purchase insurance on the borrower's behalf. Standard Fannie Mae/Freddie Mac documents permit the servicer or lender to add those charges to the principal amount of the loan.

FEMA developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with force placement procedures. FEMA published these procedures in the Federal Register on August 29, 1995 (60 FR 44881). Appendix A of FEMA's September 2007 Mandatory Purchase of Flood Insurance Guidelines sets out the MPPP Guidelines and Requirements, including force placement procedures and examples of notification letters to be used in connection with the MPPP.

58. Can a servicer force place on behalf of a lender?

Answer: Yes. Assuming the statutory prerequisites for force placement are met, and subject to the servicing contract between the lender and the servicer, the Act clearly authorizes servicers to force place flood insurance on behalf of the lender, following the procedures set forth in the Regulation.

59. When force placement occurs, what is the amount of insurance required to be placed?

Answer: The amount of flood insurance coverage required is the same regardless of how the insurance is placed. (See Section II. Determining the appropriate amount of flood insurance required under the Act and Regulation and also Section VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA.)

60. Can the 45-day notice period be accelerated by sending notice to the borrower prior to the actual date of expiration of flood insurance coverage?

Answer: [Reserved]

61. Is a reasonable period of time allowed after the end of the 45-day notice period for a lender or its servicer to implement force placement?

Answer: [Reserved]

62. Does a lender or its servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period?

Answer: [Reserved]

XI. Private Insurance Policies

63. May a lender rely on a private insurance policy to meet its obligation to ensure that its designated loans are covered by an adequate amount of flood insurance?

Answer: It depends. A private insurance policy may be an adequate substitute for NFIP insurance if it meets the criteria set forth by FEMA in its Mandatory Purchase of Flood Insurance Guidelines. Similarly, a private insurance policy may be used to supplement NFIP insurance for designated loans where the property is underinsured if it meets the criteria set forth by FEMA in its Mandatory Purchase of Flood Insurance Guidelines. FEMA states that, to the extent that a private policy differs from the NFIP Standard Flood Insurance Policy, the differences should be carefully examined before the policy is accepted as sufficient protection under the law. FEMA also states that the suitability of private policies need only be considered when the mandatory purchase requirement applies.

64. When may a lender rely on a private insurance policy that does not meet the criteria set forth by FEMA?

Answer: A lender may rely on a private insurance policy that does not meet the criteria set forth by FEMA only in limited circumstances. For example, when a flood insurance policy has expired and the borrower has failed to renew coverage, private insurance policies that do not meet the criteria set forth by FEMA, such as private insurance policies providing portfolio-wide blanket coverage, may be useful protection for the lender for a gap in coverage in the period of time before a force placed policy takes effect. However, the lender must still force place adequate coverage in a timely manner, as required, and may not rely on a private insurance policy that does not meet the criteria set forth by FEMA on an ongoing basis.

XII. Required Use of Standard Flood Hazard Determination Form (SFHDF)

65. Does the SFHDF replace the borrower notification form?

Answer: No. The SFHDF is used by the lender to determine whether the building or mobile home offered as collateral security for a loan is or will be located in an SFHA in which flood [[Page 35945]] insurance is available under the Act. The notification form, on the other hand, is used to notify the borrower(s) that the building or mobile home is or will be located in an SFHA and to inform them about flood insurance requirements and the availability of Federal disaster relief assistance.

66. May a lender provide the SFHDF to the borrower?

Answer: Yes. While not a statutory requirement, a lender may provide a copy of the flood determination to the borrower so the borrower can provide it to the insurance agent in order to minimize flood zone discrepancies between the lender's determination and the borrower's policy. A lender would also need to make the determination available to the borrower in case of a special flood hazard determination review, which must be requested jointly by the lender and the borrower. In the event a lender provides the SFHDF to the borrower, the signature of the borrower is not required to acknowledge receipt of the form.

67. May the SFHDF be used in electronic format?

Answer: Yes. In the final rule adopting the SFHDF, FEMA stated: ``If an electronic format is used, the format and exact layout of the Standard Flood Hazard Determination Form is not required, but the fields and elements listed on the form are required. Any electronic format used by lenders must contain all mandatory fields indicated on the form.'' It should be noted, however, that the lender must be able to reproduce the form upon receiving a document request by its Federal supervisory agency.

68. May a lender rely on a previous determination for a refinancing or assumption of a loan or multiple

loans to the same borrower secured by the same property?

Answer: It depends. Section 528 of the Act, 42 U.S.C. 4104b(e), permits a lender to rely on a previous flood determination using the SFHDF when it is increasing, extending, renewing, or purchasing a loan secured by a building or a mobile home. Under the Act, the ``making'' of a loan is not listed as a permissible event that permits a lender to rely on a previous determination. When the loan involves a refinancing or assumption by the same lender who obtained the original flood determination on the same property, the lender may rely on the previous determination only if the original determination was made not more than seven years before the date of the transaction, the basis for the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made. A loan refinancing or assumption made by a lender different from the one who obtained the original determination constitutes a new loan, thereby requiring a new determination. Further, if the same lender makes multiple loans to the same borrower secured by the same improved real estate, the lender may rely on its previous determination if the original determination was made not more than seven years before the date of the transaction, the basis for the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made.

XIII. Flood Determination Fees

69. When can lenders or servicers charge the borrower a fee for making a determination?

Answer: There are four instances under the Act and Regulation when the borrower can be charged a specific fee for a flood determination:

When the determination is made in connection with the making, increasing, extending, or renewing of a loan that is initiated by the borrower;

When the determination is prompted by a revision or updating by FEMA of floodplain areas or flood-risk zones;

When the determination is prompted by FEMA's publication of notices or compendia that affect the area in which the security property is located; or

When the determination results in force placement of insurance.

Loan or other contractual documents between the parties may also permit the imposition of fees.

70. May charges made for life-of-loan reviews by flood determination firms be passed along to the borrower?

Answer: Yes. In addition to the initial determination at the time a loan is made, increased, renewed, or extended, many flood determination firms provide a service to the lender to review and report changes in the flood status of a dwelling for the entire term of the loan. The fee charged for the service at loan closing is a composite one for conducting both the original and subsequent reviews. Charging a fee for the original determination is clearly within the permissible purpose envisioned by the Act. The Agencies agree that a determination fee may include, among other things, reasonable fees for a lender, servicer, or third party to monitor the flood hazard status of property securing a loan in order to make determinations on an ongoing basis.

However, the life-of-loan fee is based on the authority to charge a determination fee and, therefore, the monitoring fee may be charged only if the events specified in the answer to Question 69 occur. Further, a lender may not charge a composite determination and life-of-loan fee if the loan does not close, because the life-of-loan fee would be an unearned fee in violation of the Real Estate Settlement Procedures Act.

XIV. Flood Zone Discrepancies

71. What should a lender do when there is a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy?

A lender should only be concerned about a discrepancy on the Standard Flood Hazard Determination Form (the SFHDF) and the one on the flood insurance policy if the discrepancy is between a high-risk zone (A or V) and a low- or moderate-risk zone (B, C, D, or X). In other words, a lender need not be concerned about subcategory differences between flood zones on these two documents. Once in possession of a copy of the flood insurance policy, a lender should systematically compare the flood zone designation on the policy with the zone shown on the SFHDF. If the flood insurance policy shows a lower risk zone than the SFHDF, then lender should investigate. As noted in FEMA's Mandatory Purchase of Flood Insurance Guidelines, Federal law sets the ultimate responsibility to place flood insurance on the lender, with limited reliance permitted on third parties to the extent that the information that those third parties provide is guaranteed.

A lender should first determine whether the difference results from the application of the NFIP's ``Grandfather Rule.'' This rule 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 for the particular flood zone where the property is located. The Grandfather Rule allows policyholders who have maintained continuous coverage and/or who have built in compliance with the Flood Insurance Rate Map to continue to benefit from the prior, more favorable [[Page 35946]] rating for particular pieces of improved property. A discrepancy resulting from application of the NFIP's Grandfather Rule is reasonable and acceptable, but the lender should substantiate these findings.

A lender should also determine whether a difference in flood zone designations is the result of a mistake. To do so, a lender should facilitate communication between itself or the third-party service provider that performed the flood hazard determination for the lender. If it appears that the discrepancy is the result of a mistake, a lender should recheck its determination. If there still appears to be a discrepancy after this step has been taken, a lender and borrower may jointly request that FEMA review the determination to confirm or review the accuracy of the original determination performed by a lender or on the lender's behalf. However, FEMA will only conduct this review if the request is submitted within 45 days of the date the lender notified the borrower that a building or manufactured home is in an SFHA and flood insurance is required.

If, despite these efforts, the discrepancy is not resolved, or in the course of attempting to resolve a discrepancy, a borrower or an insurance company or its agent is uncooperative in assisting a lender in this attempt, the lender should notify the insurance agent about the insurer's duty pursuant to FEMA's letter of April 16, 2008 (W-08021), to write a flood insurance policy that covers the most hazardous flood zone. When providing this notification, the lender should include its zone information and it should also notify the insurance company itself. The lender should substantiate these communications in its loan file.

72. Can a lender be found in violation of the requirements of the Regulation if, despite the lender's diligence in making the flood hazard determination, notifying the borrower of the risk of flood and the need to obtain flood insurance, and requiring mandatory flood insurance, there is a discrepancy

between the flood hazard zone designation on the flood determination form and the flood insurance policy?

Answer: As noted in question and answer 71 above, lenders should have a process in place to identify and resolve flood zone discrepancies. A lender is in the best position to coordinate between the various parties involved in a mortgage loan transaction to resolve any flood zone discrepancy. If a lender is able to substantiate in its loan file a bona fide effort to resolve a discrepancy, either by finding a legitimate reason for such discrepancy or by attempting to resolve the discrepancy, for example, by contacting FEMA to review the determination, no violation will be cited. If a pattern or practice of unresolved discrepancies is found in a lender's loan portfolio due to a lack of effort on the lender's part to resolve such discrepancies, the Agencies may cite the lender for a violation of the mandatory purchase requirements.

XV. Notice of Special Flood Hazards and Availability of Federal Disaster Relief

73. Does the notice have to be provided to each borrower for a real estate related loan?

Answer: No. In a transaction involving multiple borrowers, the lender need only provide the notice to any one of the borrowers in the transaction. Lenders may provide multiple notices if they choose. The lender and borrower(s) typically designate the borrower to whom the notice will be provided. The notice must be provided to a borrower when the lender determines that the property securing the loan is or will be located in an SFHA.

74. Lenders making loans on mobile homes may not always know where the home is to be located until just prior to, or sometimes after, the time of loan closing. How is the notice requirement applied in these situations?

Answer: When it is not reasonably feasible to give notice before the completion of the transaction, the notice requirement can be met by lenders in mobile home loan transactions if notice is provided to the borrower as soon as practicable after determination that the mobile home will be located in an SFHA. Whenever time constraints can be anticipated, regulated lenders should use their best efforts to provide adequate notice of flood hazards to borrowers at the earliest possible time. In the case of loan transactions secured by mobile homes not located on a permanent foundation, the Agencies note that such ``home only'' transactions are excluded from the definition of mobile home and the notice requirements would not apply to these transactions.

However, as indicated in the preamble to the Regulation, the Agencies encourage a lender to advise the borrower that if the mobile home is later located on a permanent foundation in an SFHA, flood insurance will be required. If the lender, when notified of the location of the mobile home subsequent to the loan closing, determines that it has been placed on a permanent foundation and is located in an SFHA in which flood insurance is available under the Act, flood insurance coverage becomes mandatory and appropriate notice must be given to the borrower under those provisions. If the borrower fails to purchase flood insurance coverage within 45 days after notification, the lender must force place the insurance.

75. When is the lender required to provide notice to the servicer of a loan that flood insurance is required?

Answer: Because the servicer of a loan is often not identified prior to the closing of a loan, the Regulation requires that notice be provided no later than the time the lender transmits other loan data, such as information concerning hazard insurance and taxes, to the servicer.

76. What will constitute appropriate form of notice to the servicer?

Answer: Delivery to the servicer of a copy of the notice given to the borrower is appropriate notice. The Regulation also provides that the notice can be made either electronically or by a written copy.

77. In the case of a servicer affiliated with the lender, is it necessary to provide the notice?

Answer: Yes. The Act requires the lender to notify the servicer of special flood hazards and the Regulation reflects this requirement. Neither contains an exception for affiliates.

78. How long does the lender have to maintain the record of receipt by the borrower of the notice?

Answer: The record of receipt provided by the borrower must be maintained for the time that the lender owns the loan. Lenders may keep the record in the form that best suits the lender's business practices. Lenders may retain the record electronically, but they must be able to retrieve the record within a reasonable time pursuant to a document request from their Federal supervisory agency.

79. Can a lender rely on a previous notice if it is less than seven years old, and it is the same property, same borrower, and same lender?

Answer: No. The preamble to the Regulation states that subsequent transactions by the same lender with respect to the same property will be treated as a renewal and will require no new determination. However, neither the Regulation nor the preamble addresses waiving the requirement to provide the notice to the borrower. [[Page 35947]] Therefore, the lender must provide a new notice to the borrower, even if a new determination is not required.

80. Is use of the sample form of notice mandatory?

Answer: No. Although lenders are required to provide a notice to a borrower when it makes, increases, extends, or renews a loan secured by an improved structure located in an SFHA, use of the sample form of notice provided in Appendix A of the Regulation or in Appendix 4 of FEMA's Mandatory Purchase of Flood Insurance Guidelines is not mandatory. It should be noted that the sample form includes other information in addition to what is required by the Act and the Regulation. Lenders may personalize, change the format of, and add information to the sample form of notice, if they choose. However, a lender-revised notice must provide the borrower with at least the minimum information required by the Act and Regulation. Therefore, lenders should consult the Act and Regulation to determine the information needed.

XVI. Mandatory Civil Money Penalties

81. Which violations of the Act can result in a mandatory civil money penalty?

Answer: A pattern or practice of violations of any of the following requirements of the Act and their implementing Regulation triggers a mandatory civil money penalty:

Purchase of flood insurance where available (42 U.S.C. 4012a(b));

Escrow of flood insurance premiums (42 U.S.C. 4012a(d));

Force placement of flood insurance (42 U.S.C. 4012a(e));

Notice of special flood hazards and the availability of Federal disaster relief assistance (42 U.S.C. 4104a(a)); and

Notice of servicer and any change of servicer (42 U.S.C. 4101a(b)).

The Act states that any regulated lending institution found to have a pattern or practice of certain violations ``shall be assessed a civil penalty'' by its Federal supervisor in an amount not to exceed $350 per violation, with a ceiling per institution of $100,000 during any calendar year (42 U.S.C. 4012a(f)(5)). Each Agency adjusts these limits pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, 28 U.S.C. 2461 note.\13\ Lenders pay the penalties into the National Flood Mitigation Fund held by the Department of the Treasury for the benefit of FEMA.

\13\ Please refer to 12 CFR 19.240(a) (OCC); 12 CFR 263.65(b)(10) (Board); 12 CFR 308.132(c)(xvi) (FDIC); 12 CFR 509.103(c) (OTS); 12 CFR 622.61(b) (FCA); and 12 CFR 747.1001(a) (NCUA) for the Agencies' current civil penalty limits.

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82. What constitutes a ``pattern or practice'' of violations for which civil money penalties must be imposed under the Act?

Answer: The Act does not define ``pattern or practice.'' The Agencies make a determination of whether a pattern or practice exists by weighing the individual facts and circumstances of each case. In making the determination, the Agencies look both to guidance and experience with determinations of pattern or practice under other regulations (such as Regulation B (Equal Credit Opportunity) and Regulation Z (Truth in Lending)), as well as Agencies' precedents in assessing civil money penalties for flood insurance violations.

The Policy Statement on Discrimination in Lending (Policy Statement) provided the following guidance on what constitutes a pattern or practice:

Isolated, unrelated, or accidental occurrences will not constitute a pattern or practice. However, repeated, intentional, regular, usual, deliberate, or institutionalized practices will almost always constitute a pattern or practice. The totality of the circumstances must be considered when assessing whether a pattern or practice is present.

In determining whether a financial institution has engaged in a pattern or practice of flood insurance violations, the Agencies' considerations may include, but are not limited to, the presence of one or more of the following factors:

Whether the conduct resulted from a common cause or source within the financial institution's control;

Whether the conduct appears to be grounded in a written or unwritten policy or established practice;

Whether the noncompliance occurred over an extended period of time;

The relationship of the instances of noncompliance to one another (for example, whether the instances of noncompliance occurred in the same area of a financial institution's operations);

Whether the number of instances of noncompliance is significant relative to the total number of applicable transactions. (Depending on the circumstances, however, violations that involve only a small percentage of an institution's total activity could constitute a pattern or practice);

Whether a financial institution was cited for violations of the Act and Regulation at prior examinations and the steps taken by the financial institution to correct the identified deficiencies;

Whether a financial institution's internal and/or external audit process had not identified and addressed deficiencies in its flood insurance compliance; and

Whether the financial institution lacks generally effective flood insurance compliance policies and procedures and/or a training program for its employees.

Although these guidelines and considerations are not dispositive of a final resolution, they do serve as a reference point in assessing whether there may be a pattern or practice of violations of the Act and Regulation in a particular case. As previously stated, the presence or absence of one or more of these considerations may not eliminate a finding that a pattern or practice exists.

End of text of the Interagency Questions and Answers Regarding Flood Insurance.

Dated: May 15, 2009.

John C. Dugan,
Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, July 14, 2009.

Jennifer J. Johnson,
Secretary of the Board.

Dated at Washington, DC, this 8th day of July, 2009.

Robert E. Feldman,
Executive Secretary, Federal Deposit Insurance Corporation.

Dated: April 2, 2009.

By the Office of Thrift Supervision.

John E. Bowman,
Acting Director.

Date: July 8, 2009

Roland E. Smith,
Secretary, Farm Credit Administration Board.

By the National Credit Union Administration Board, on June 5, 2009.

Mary F. Rupp,
Secretary of the Board.

[FR Doc. E9-17129 Filed 7-20-09; 8:45 am]

BILLING CODE 4810-33-P