

December 1, 2011

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Re: Loans in Areas having Special Flood Hazards: Interagency Questions and Answers Regarding Flood Insurance; OCC Docket ID OCC-2011-0024; FRB Docket No. OP-1431; FDIC RIN 3064-ZA00; FCA RIN 3052-AC46; NCUA RIN 3133-AD41

Ladies and Gentlemen:

The American Bankers Association (ABA)¹ appreciates the opportunity to comment on the Interagency Questions and Answers Regarding Flood Insurance (the Questions and Answers)² proposed by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation,

¹ The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than \$165 million in assets.

² 76 Fed. Reg. 64175 (October 17, 2011).

the Farm Credit Administration, and the National Credit Union Administration (collectively, the Agencies).

Summary of Comment

ABA appreciates the Agencies ongoing efforts to provide guidance and clarity to financial institutions about their flood compliance obligations. Our members welcome the Agencies' work to promote the consistent interpretation, application, and examination of the Act and its implementing regulations. However, as stated in ABA's comments to the proposed Questions and Answers published in 2008 and 2009, the simple mandate established by Congress in the National Flood Insurance Reform Act of 1994 (the Act) – ensuring that a bank does not “make, increase, extend or renew any designated loan unless the building or mobile home securing the property is covered by flood insurance for the term of the loan” – has grown into an alarmingly complex and burdensome compliance obligation. The fact that there are 82 Questions and Answers (spanning 33 Federal Register pages) required to “guide” bankers illustrates and underscores this complexity.

The banking industry cautions against using the Questions and Answers to extend a bank's duty and liability for ensuring compliance with the mandatory purchase requirements beyond the statutory framework established by Congress. As discussed in our prior comments, ABA believes that the Questions and Answers evince a troubling trend to assign ever-increasing responsibility to financial institutions to assume responsibilities and to make determinations that should be the responsibility of the National Flood Insurance Program (NFIP) and its insurance agents. ABA urges the Agencies to recognize that the statutory scheme established by Congress assigned to banks a limited *supporting role* in the larger flood management program administered by the Federal Emergency Management Agency (FEMA) through the NFIP. We believe that the dual goals of ensuring that property owners are properly insured against flood risk and that the federal treasury is not overburdened by avoidable disaster relief payments can be more efficiently achieved by keeping the primary responsibility where Congress originally assigned it, with FEMA and the NFIP.

Question and Answer 9: Determining the “insurable value” of a building

To that end, we urge the Agencies to reconsider Question and Answer 9 on calculating the “insurable value” of a building. ABA appreciates the fact that the Agencies now recognize that insurable value determinations cannot be reduced to a simple formula applicable to all properties and have modified their 2009 proposal to define insurable value as 100% replacement cost value (RCV). However, we believe that this conclusion compels another – the acknowledgement that insurable value determinations are ultimately judgments best left to insurance experts. As discussed at length in our prior comments, requiring bankers to make these judgments is neither practical nor appropriate as it will significantly increase borrower costs and further increase borrower resistance to the federally mandated purchase of flood insurance.

Yet, the Agencies new proposal, which amounts to little more than a list of alternative methods that may be used by a bank to determine and document insurable value, does little to address the inherent limitations of each. As discussed in detail in ABA's 2009 comment letter on the proposed definition of insurable value, these include:

- Hazard insurance policies do not always include a replacement cost value as many borrowers do not purchase a hazard insurance policy that insures to replacement cost.
- For those hazard insurance policies that do insure to the structure's replacement cost, that figure excludes the cost of the foundation, forcing the bank to try to estimate the replacement cost of the foundation – an expensive undertaking and one of questionable reliability.
- Hazard insurance policies written for commercial properties securing commercial loans rarely assign values to individual properties.
- Construction-cost appraisals are expensive and of questionable accuracy; for commercial properties, determining a depreciated value is an inexact process, at best.³

Nevertheless, nothing in Question and Answer 9 acknowledges these limitations or the resulting compliance burden and cost, which will be significant. Even more significantly, these additional compliance burdens and costs carry with them no assurance of enhanced protection from flood losses. Indeed, our members believe that Question and Answer 9 ensures only one thing – greater examiner scrutiny, and criticism of, insurable value calculations.

To avoid this result, we urge the Agencies to recognize and acknowledge that determining and documenting the insurable value of a property is the responsibility of insurance agents, not bankers, and to work with the banking industry and FEMA to redirect responsibility to the insurance experts.⁴ As precedent, we note the October 1, 2007, directive by FEMA to its direct and Write-Your-Own insurance agents to record the replacement cost value of a condominium (and the number of units in that condominium) on the declaration page of an RCBAB policy, the master flood insurance policy for a condominium. This directive was followed by welcome interagency guidance to the banking industry: "Lenders may rely on the replacement cost value and the number of units on the RCBAP declaration page in determining the insurable value unless they have reason to believe that such amounts clearly conflict with other available information."⁵ Our members report that this coordinated effort by FEMA and the Agencies resolved many of the challenges the industry faced previously trying to

³ See ABA comment letter, Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance, September 21, 2009, pages 4 – 7, attached.

⁴ Our members report significant frustration generated by the unresponsiveness of insurance agents to questions about insurable value calculations.

⁵ See 74 Fed. Reg. 35914, 35938 (July 21, 2009) (Question and Answer 28).

determine whether a condominium unit was adequately insured under the Act and its implementing regulations.

ABA urges the Agencies to support a similar solution for *all* insurable value determinations that recognizes the role and responsibility of the insurance expert. We support a meeting with appropriate representatives of FEMA, the NFIP, the Agencies, and the banking and insurance industries to discuss the challenges presented by insurable value determinations and the need for a solution. We believe this solution can mirror that imposed for condominiums: a requirement by FEMA that its insurance agents state on the declarations page of an NFIP policy the insurable value of each building offered as collateral for the loan, and the replacement of Question and Answer 9 with an Interagency statement that banks may rely on the FEMA agent's insurable value determination unless they have reason to believe that such amounts clearly conflict with other available information.

Questions and Answers 57, 60 – 62: Force Placement of Flood Insurance

Again, we note at the outset our appreciation that the Agencies have re-proposed the Questions and Answers on force placement. We are pleased that the Agencies expressly recognize a bank or servicer's right to force place – and charge the borrower – within the 45-day notice period. However, ABA has continuing concerns with statements in the newly proposed Questions and Answers that reflect a persistent misunderstanding of the Act and have the potential to expand significantly and inappropriately a bank's flood compliance obligations.

In particular, we object to Question and Answer 62 insofar as it conditions the ability of a lender or servicer to charge a borrower for the cost of force placed insurance on a contractual provision. Question and Answer 62 states:

A lender or its servicer may charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance is in effect, *if the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made.*⁶

As discussed in our comment to the July 2009 Questions and Answers, following multi-million dollar flood damage in the Midwest in 1993, Congress amended the Flood Disaster Protection Act of 1973 to strengthen compliance with the mandatory purchase requirement. Congress added section 524 to ensure that borrowers maintain continuous coverage for the life of the loan. Section 524, *not a contractual provision*, authorizes a bank or servicer to charge the borrower for the cost of premiums or fees incurred in purchasing the force placed policy.⁷

⁶ See 76 Fed. Reg. *supra* at 64180 (emphasis added).

⁷ 42 U.S.C. §4012a(e).

Moreover, by inserting the gratuitous requirement that a contract provision exist, the Agencies would create a servicing nightmare. Although current contract covenants in Fannie Mae and Freddie Mac uniform first mortgage security instruments may satisfy this requirement, contractual provisions in commercial loan security contracts and older mortgage security contracts may not. Thus, prior to force placement, a bank or servicer would be required to retrieve and review the loan documentation to determine whether the contract authorizes the lender to charge the borrower, an analysis likely to result in litigation over whether a particular contractual provision satisfies the standard of “express authority to charge the borrower.” ABA urges the Agencies to delete the statement in Question and Answer 62 that ties the right to charge a borrower for the cost of force placed insurance to the existence of a contractual right to do so and instead to confirm clearly that the ability to charge a borrower when flood insurance is properly force placed is based upon statutory authority.

In addition, we caution against the insertion of statements of “encouragement” or “best practices” throughout the Questions and Answers on force placement. As the Agencies are undoubtedly aware, the publication of the new Questions and Answers virtually guarantees examination of force placement policies and procedures to the letter of the guidance, resulting in statements of encouragement or industry best practices becoming *de facto* regulatory requirements. The legitimate purpose of the Question and Answer is to clarify regulatory requirements, not to impose new supervisory expectations that are not compelled by the Act.

Consequently, we oppose insertion of statements that may be construed to require explanation of a bank’s policy on charging for force placement coverage during the 45-day notice period, the timing of that charge, and the fact that force placement insurance may be more expensive than a borrower-purchased policy. We also urge the Agencies to delete the statement recommending that “the lender also advise the borrower when flood insurance on the collateral is *about to expire*” (emphasis added). As stated above, all too often such statements are enforced in the field like regulatory requirements, limiting institutional discretion on the timing and content of customer communications.

Similarly, we oppose the statement in Question and Answer 60 “encouraging” lenders and servicers to escrow flood insurance premiums. ABA has consistently opposed the imposition of escrow requirements because of the compliance burden and increased costs associated with establishing and maintaining escrow accounts, and commercial loans systems are rarely, if ever, set up to escrow for taxes or insurance. To avoid any confusion about an institution’s regulatory requirements, we urge the Agencies to clarify that the escrow of flood insurance is not required under the Act unless an institution escrows for other purposes. Congress sought to accommodate community banks, which often do not escrow in the normal course of real estate lending from incurring such costs just for fulfilling the statutory flood insurance requirement. It is not the place of the Agencies to eliminate that legislative accommodation or “encourage” practices contrary to the accommodation.

Finally, in proposed Question 57, the Agencies correctly recite the occasions that mandate a force placement notice and the required content of the notice. However, this notice is to be distinguished from the Notice of Special Flood Hazards and Availability of Federal Disaster Assistance (the Flood Determination Notice). ABA objects to the insertion of statements that it is an industry “best practice” to also send the Flood Determination Notice with the force placement notice. The Act and its implementing regulations establish four “triggers” for the Flood Determination Notice – the making, increasing, extending, or renewing a loan – none of which are implicated at force placement. Moreover, many of our members believe that sending the Flood Determination Notice at this time may confuse customers; they urge deletion of this statement about industry best practices. In other words, there is no industry consensus that the asserted practice is a “best practice.”

Conclusion

ABA appreciates the opportunity to comment on the Interagency Questions and Answers Regarding Flood Insurance. We fervently hope that the further clarifications we suggest can be adopted by the Agencies in short order.

In addition, ABA invites the Agencies to co-sponsor a meeting of government, regulatory, insurance and banking industry representatives to resolve the insurable value issues that continue to plague flood insurance compliance efforts.

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

Respectfully submitted,



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