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May 20, 2008

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN number 3064-ZA00

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Jennifer J. Johnson, Secretary
Board of Governors
of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. OP-1311

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Docket ID OCC-2008-0002

Gary K. Van Meter, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2008-0001

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

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the proposed updates and revisions to the guidelines offered

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing over 282,000 Americans, ICBA members hold more than $982 billion in assets, $788 billion in deposits, and

by the agencies to help banks comply with flood insurance mandates. Compliance with flood insurance rules and requirements can be especially challenging and any guidance offered by the agencies to assist banks is welcome.

Background

The federal bank, thrift, credit union and Farm Credit System regulatory agencies have asked for comment on proposed new and revised interagency questions and answers on flood insurance requirements. The agencies and the Federal Emergency Management Agency (FEMA) are proposing an extensive update designed to respond to questions raised since the last guidelines were issued in 1997. The proposal also offers new guidance in areas such as second liens, imposition of civil money penalties and participations.

The proposed changes include substantive modifications to questions and answers pertaining to construction loans and condominiums, new guidelines for handling discrepancies between flood zone descriptions in the flood determination form and the flood insurance policy, and a re-organization to make the guidance easier to use. Finally, the agencies propose to update and clarify a number of existing Q&As to make compliance simpler. Overall, the proposal is intended to assist financial institutions by addressing the most frequently asked questions and to help increase public awareness of flood insurance rules.

Overview of ICBA Comments

Generally, ICBA supports the changes since they are designed to facilitate compliance with a complex and often confusing area of regulation. ICBA strongly encourages the agencies to continue to update the guidelines more frequently, especially since new legislation being considered by Congress is likely to increase the penalties for non-compliance.[2]

It is equally important that the guidelines be limited to compliance with flood insurance rules and not overlay general safety and soundness standards onto the guidance, e.g., where the guidelines state a portfolio review is not required but strongly encouraged, a risk-based assessment or good faith element be incorporated as well. There are times when other elements of due diligence or safety and soundness come into play for other reasons. For example, the relationship between a third party provider and a community bank is covered by other rules and regulations and should be treated separately and not duplicated unnecessarily here.

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more than $681 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

[2] S.2284, the Flood Insurance Reform and Modernization Act of 2007, adopted by the Senate earlier this month would increase the penalty for an individual infraction to $2,000 with no limit on the total amount that could be assessed, greatly increasing the potential risk for banks and other lenders. See also HR 3121.

All too often community banks report that "best practices" or "recommendations" quickly become back-door mandates during the examination process. Therefore, it is critical that this be factored into the final guidance and that it is clearly stressed that a best practice is *not* a mandate. Equally important to achieve this goal is a risk-based flexibility that grants recognition to good faith reasonable efforts to comply. Otherwise, the guidance becomes flawed, as in the example of a portfolio review: the guidance would state a portfolio review is not required but every lender will understand otherwise.

Moreover, ICBA urges the agencies to carefully consider several instances where they unfairly assign responsibility to banks and other lenders. For example, if there is a discrepancy between a flood hazard determination and the insurance policy, the guidance places the responsibility on the lender to resolve the discrepancy when this may be entirely beyond the lender's control. Until flood maps are simple, accurate and up-to-date, this is an unfair burden to place on any lender. The final guidance should allow lenders to make a good faith effort to resolve the problem but should not place lenders in the unfair and untenable position of being entirely responsible for the resolution. Similarly, in determining the value of property being insured, lenders should be able to rely on determinations by insurance agents who are better equipped to make those determinations. And, since a lender for a mortgage on a condominium within a building is not likely to hold any leverage over the homeowner's association, that should be acknowledged in the final guidance. In other words, lenders should be responsible for elements they can control but not for those they cannot.

Perhaps the single most vexing issue confronting community banks and their efforts to comply with flood insurance requirements is attempting to determine whether a specific property of building is located in a flood hazard zone. ICBA strongly encourages the agencies and FEMA to take steps to facilitate the process, especially focusing on automation and taking advantage of new technologies to make it relatively simple for bankers and borrowers to determine whether a property is located in a flood hazard zone.

The agencies note that one purpose for the revision is to increase public awareness. ICBA strongly encourages the agencies to expand education efforts to ensure that borrowers clearly understand the requirements to have and maintain flood insurance. Since Congress appears poised to enact new flood insurance legislation, now would be an opportune moment to advance educational efforts. ICBA also encourages the agencies to develop a readily accessible pamphlet for lenders to provide to customers that answers questions about flood insurance coverage in simple language. ICBA also recommends such an educational brochure be available in different languages. Having such information available under a government seal of approval would ease the difficulties of explaining flood insurance requirements and would help borrowers understand that the requirements are due to a government mandate and not the whim of the lender. It is equally important that when developing educational materials, the agencies work with consumers and conduct consumer testing to ensure the materials accomplish the goal and properly conveys the needed information.

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Finally, as suggested above, ICBA strongly recommends that examination procedures use a risk-based approach as well as incorporate recognition for good faith efforts on the part of the bank. Compliance with flood zone maps, determining appropriate value, and otherwise meeting the demands of flood insurance laws and regulations can be complex and difficult. It is critical that good faith efforts and inadvertent errors not be penalized. This is especially important in today's economy, when determining and evaluating the worth of a specific property can be extremely difficult, especially in rural areas. For example, ICBA applauds the interagency guidance proposed to help determine appropriate value of a property. Overall, ICBA encourages the agencies to hold training sessions for both examiners and lenders to explain these changes, either by in-person seminars, offering webinars or telephone audio presentations.

ICBA Comments on Specific Provisions

Determining When Flood Insurance is Required

If a building securing a loan is located in a special flood hazard area (SFHA), even though the community does not participate in the flood program, the proposal would clarify that the flood insurance rules still apply although flood insurance would not be required (question 1). Similarly, if a building is no longer located in an SFHA due to a change in mapping, flood insurance would no longer be required (question 2).

ICBA finds this guidance helpful. Any information that clarifies when flood insurance is necessary is helpful. Both points in questions one and two are important for banks to remember and can easily be overlooked. Banks need to remember that the flood insurance rules are designed to protect the owner and the government, as well as the bank, in the event of a flood. The first step should always be assessing the risk of flood damage and the proposal reminds all parties that this is required even though flood insurance may not be required or available. This risk needs to be clearly conveyed to the borrower if the property is located in a flood plain even though insurance may not be required or may not be available because the community does not participate in the flood program. This is the type of information that an educational brochure should include to help borrowers understand that compliance with flood insurance rules is mandatory but flood insurance itself may not be required.[3]

Similarly, if a building is not in an SFHA because of a change in mapping, customers should not be required to maintain flood insurance and the coverage can be eliminated. Since insurance can place an undue financial burden on customers, this is helpful guidance. Fundamentally, the regulation should protect the customer, not unfairly tax them.

***Loan Purchase*.** The proposal would provide that the requirements do not apply to the purchase of a loan, since the rule is triggered only by the making, increasing, extension or renewal of a loan (question 3). **Generally, ICBA believes this is useful**

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[3] It is equally important that examiners understand this distinction and not penalize a lender for failing to require flood insurance if the local community does not participate.

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since it helps clarify where the responsibility lies: with the originator of the loan. By clearly identifying which entity is responsible it also helps eliminate duplication of effort.

However, ICBA recommends that the agencies take several steps to further clarify this element. First, this provision needs to be reconciled with the rules that apply to participation loans, since the guidance is inconsistent and takes one approach for an outright purchase but an entirely different approach when a lender purchases less than 100% of the loan.[4]

Second, if a lender is not required to verify compliance for a purchased loan, examiners need to clearly understand that. If the guidance states that a purchaser need not take additional steps then the bank should not be later criticized. However, since the goal of the flood insurance law and regulations is to protect both the borrower and the lender, it is equally important to require that loan *sellers* provide some certification to verify compliance.

Defaults. If a loan is restructured due to the borrower's default, the proposal would clarify that a flood insurance determination is still needed (question 4). **ICBA agrees** with this requirement. It is consistent with the overall requirements mandating when a flood hazard determination is needed and is a logical time for the lender to make a new determination.

Table Funding. The proposal would clarify that table funded loans are treated as new loan originations and therefore subject to the requirements (question 5). **ICBA agrees with the proposed guidance**. Table funded loans are new loan originations and borrowers who go through a mortgage broker should be afforded the same protection as other borrowers. The proposal leaves no question that table funded loans are subject to flood requirements. Although the proposed guidance includes a cross-reference to the definition of table funding established by the Department of Housing and Urban Development (HUD), including the definition in the final flood insurance Q&A for ease of reference would be helpful.

Portfolio Reviews. The final question in this section would clarify that a portfolio review is *not* required, although may be useful as a sound practice (question 6). **While ICBA finds the guidance helpful, it would also be worthwhile to provide additional clarification**. The proposal states that while a portfolio review is not required, "sound risk management practices may lead a lender to conduct scheduled periodic reviews." To avoid confusion, ICBA urges the agencies to make it clear in the final guidance that while a portfolio review is not required *for purposes of the flood insurance rules and regulations*, lenders should consider it a best practice to periodically review their loan portfolios, including an assessment of insurance coverage, to meet other regulatory requirements and mandates. It is equally critical that both lenders and examiners understand the distinction between what is required for safety and soundness and what is required to comply with the flood insurance rules. As currently worded, the distinction is not entirely clear and can become further blurred over time, adding to potential confusion

[4] Ironically, as proposed, the guidance places greater responsibility on a community bank that purchases less than 100% of a loan.

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and therefore unnecessarily increasing regulatory burden. Moreover, the way the proposal is worded, no community bank would run the risk of examiner criticism by not conducting a regular portfolio review. In other words, as proposed, the guidance seems to say that a portfolio is not required but then implicitly requires it.

Appropriate Amount of Flood Insurance

Under the rules, the minimum amount of flood insurance required for a loan is the lesser of the outstanding balance of the loan or the maximum amount of coverage available for that type of property. Generally, for single-family and two-to-four family dwellings, the maximum is $250,000 in coverage. For nonresidential structures, the maximum is $500,000.[5] In addition, there is a further calculation to determine coverage. The maximum is further limited to the overall value of the building securing the loan (and the value of the land is *not* included for this determination). Furthermore, unlike the valuation used for hazard insurance where the value of the foundation is excluded, it *is* included for flood insurance determination purposes.

ICBA finds the proposed guidance for calculating the "maximum limit of coverage" (question 7) generally helpful. Lenders have difficulty understanding the "maximum limit of coverage" when it comes to excluding the amount of land from the equation and focusing solely on the value of the building itself. However, in this question and in questions 10, 12, and 21 the term "insurable value" is used and in some cases it is explained to be "appraised value minus land" and in others as "100% of the full replacement cost value (RCV) including the supporting structure." There needs to be one consistently applied standard for determining the insurable value. The final guidance also should incorporate definitions that outline these terms. And, the final guidance should permit banks to place good faith reliance on insurance agents who are better equipped to make these determinations.[6]

While the distinction between hazard insurance and flood insurance is logical and although uniformity would ease compliance, the rationale for the difference needs to be clearly articulated in the final guidance. This is another area where a simple educational pamphlet or brochure that explains these requirements to borrowers and loan applicants – and bankers – would be especially useful.

Examples of Residential Property. The proposal would offer examples of residential property, including apartment dwellings, hotels, condominiums (if at least 75% of the building is residential) and nonresidential property, such as businesses, churches, farms and schools (questions 8 and 9).

ICBA finds it useful to have guidance on what is residential and non-residential. ICBA recommends, though, that rather than placing particular structures in categories, there should be an all encompassing "usage percentage" limit to determine

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[5] For participating communities in the Emergency Phase Program, the caps are $35,000 for residential properties and $100,000 for nonresidential properties.

[6] As long as a community bank has appropriate due diligence in place for the selection and evaluation of a flood insurance provider it should be allowed to rely on that third party vendor and not be required to duplicate efforts.

whether a particular building is residential or nonresidential. For example, if 75% of the building (whether an apartment, condominium, hotel, or other structure) is residential, then the building should be considered residential. If not, then it should be nonresidential. This would help address instances such as a mixed use property found in many communities where a business is on the first floor but there are living quarters on the second floor and higher.

ICBA also recommends one additional clarification in this area related to agricultural properties. A farm overall is nonresidential but for many agricultural loans the property will include the farmhouse, i.e., farmer's residence. The final guidance should explain clearly how the farmhouse is to be treated since coverage levels will vary if it is residential or non-residential.

Calculating Coverage. The proposal would include examples to help calculate the coverage required. **ICBA finds the examples** helpful for compliance since they illustrate how the calculations should work; it is always useful to have examples of calculations as a reference tool. Due to the complexity of some of the requirements, simple examples are useful.

The proposal would clarify that flood insurance is required for each building if more than one building serves as collateral (question 11) and that where the value of the property is less than the balance of the loan, flood insurance is only required up to the value of each structure and not the outstanding principal balance of the loan (question 12). The proposal also would clarify that a lender *can* require more flood insurance coverage than the minimum required by the regulation (question 13) although the additional coverage would have to be provided outside the National Flood Insurance Program (NFIP).

ICBA finds each of these proposed elements of guidance helpful. However, as more fully discussed below under the section on agricultural property, **ICBA also recommends that where the collateral is worthless and would not be replaced that flood insurance on that building not be required**. In other words, it would be helpful to clarify that worthless buildings, i.e., those that offer no value to the real estate collateral, do not have to be insured. This would be consistent with the proposed guidelines since the maximum value of the building is essentially zero but it would help to have that clarified.

One additional clarification is needed for question 12. The answer to that question states that a lender should determine the value of the structure by using the "insurable value" while the Mandatory Purchase of Flood Insurance Guidelines indicate the term "insurable value" means "100% replacement cost value" (RCV). The answer to question 12 does not require the RCV be used and so clarification explaining the relation of the terms would be helpful. If the value of the property is less than the loan balance, but lenders are required to use the "insurable value – RCV", for flood insurance coverage, a borrower may be paying premiums for coverage for which the insurance payment would not be realized in the event of a loss.

Maximum Deductible. A lender can allow a borrower to use the maximum deductible to reduce the cost of flood insurance but the proposed guidelines would suggest that lenders determine to what extent this is appropriate in each case (question 14). **Generally, ICBA supports this element of the proposal**. Lenders are often better able to evaluate a particular borrower's unique situation and provide guidance on the level of deductible the customer should accept. While it is human nature for a borrower to accept a higher deductible to reduce cost, this may not be wise. The proposal reflects this and verifies that a borrower *can* choose a high deductible to lower cost of flood insurance but that the lender needs to review deductibles on a case by case basis.

ICBA strongly encourages the agencies to clearly articulate this discretion in examination procedures to minimize questions and help minimize the tendency of some examiners to second guess the bank or create a new documentation mandate to validate the decision. If that should happen, the discretion of lenders to permit higher deductibles could become illusory.

Construction Loans

The proposal would clarify that a loan secured by a building being constructed *would* be subject to the flood insurance rules and eligible for coverage (questions 17 and 18). Buildings that do not yet have walls or a roof would be eligible for coverage unless construction stops for 90 days or more. If a building is under construction, coverage would begin when actual construction begins or when building supplies are in an enclosed building on-site or on adjacent premises. While the flood insurance determination must be done at loan origination, actual coverage would not be mandatory until construction begins as long as the lender has controls in place to ensure flood insurance is in place at the appropriate time during the loan (question 19). Finally, the construction rules would clarify that the 30-day waiting period does not apply when the purchase of flood insurance is deferred until construction begins (question 20).

Again, **ICBA finds this guidance for how to handle construction loans both appropriate and helpful for lenders**. How flood insurance applies during construction can be confusing, and anything that dispels some of the confusion is welcome.

Agricultural Buildings

There are times when farm buildings secure a loan but because they have limited use to farming operations, they would not be replaced if damaged or destroyed. The proposal would clarify that, even so, if the building serves as collateral and the property is in a participating SFHA, the building must be covered by flood insurance (question 21). The answer to the question would state that the flood requirements do not differentiate agricultural lending from other types of lending. If the loan is secured by multiple buildings in a large geographic area, then the flood determination and insurance must be made for each building (question 22).

ICBA finds this guidance helpful. It reaffirms that flood insurance requirements apply to agricultural lending and, since agricultural loans can cover larger tracts of property than other loans, clarifies how a lender should evaluate the necessary flood insurance coverage levels. However, ICBA recommends that the final guidance also

clarify that where a building is *not* included in the collateral evaluation and that it is solely the land that secures an agricultural loan, then flood insurance and a flood insurance determination is not necessary. And, if a value is worthless and has a value of zero (or nearly zero) for collateral evaluation purposes, then flood insurance coverage is unnecessary.

It would be worth considering where this guidance could be applied to other commercial or non-residential loans. As noted above, there may be instances where a building on a property that secures the loan is worthless and where a flood insurance determination or coverage would be a needless expense. In those instances, the guidance should not be limited to agricultural loans.

Residential Condominiums

The proposal would clarify that residential condominiums are subject to the flood insurance requirements (question 23). The minimum required coverage is determined by the lesser of the outstanding loan balance or the maximum insurance available (question 24) while the maximum insurance coverage available is the maximum available for a residential condominium (generally $250,000) *or* the insurance value of the unit (the replacement cost of the entire building divided by the number of units in the building).

Because condominiums are or should be covered by a residential condominium building association policy (RCBAP), the lender must take that policy into consideration for determining the requisite amount of flood insurance. If the RCBAP is sufficient to cover the replacement cost of the building *or* the total number of the units in the building times $250,000, whichever is less, then separate flood insurance coverage is not required for the unit securing the loan. Otherwise, a separate dwelling policy on the individual unit will be needed (question 24).[7] The proposal would offer examples of how these calculations are made.

If there is no RCBAP in place, then the proposal would require a lender to obtain sufficient dwelling coverage for the individual unit (question 25). **ICBA finds this an appropriate requirement to ensure that both the lender and the borrower are adequately protected**. It also helps ensure that condominium owners encourage their homeowners' association to ensure it has adequate coverage in place for the entire structure. However, it is equally important that the final guidance acknowledge that neither the lender not the borrower can dictate what the homeowner's association must do.

As with other areas of the guidance, this is information that should be clearly communicated to all consumers so that they are aware of what is required under flood insurance requirements. **ICBA recommends this information be made readily available for all consumers through educational materials created by the agencies and FEMA**. It would be helpful if this information were made available to consumers when they are shopping for a condominium since the lack of an RCBAP could be an added and burdensome expense for the individual borrower. It would also be helpful to

[7] Note that a RCBAP may only be purchased by the condominium association directly from FEMA.

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have information available for borrowers so that they clearly understand the impact where other owners in the building are not covered by flood insurance and the ramifications if the property is damaged or destroyed in a flood.

If the RCBAP is not sufficient to cover the unit that secures the loan, the proposal encourages the lender to have the borrower ask the condominium association to increase its RCBAP coverage to an appropriate level. If the association does not do so, then the lender must require the borrower to obtain additional flood insurance to meet the requirements for the coverage on the individual unit (question 26). In addition, the proposal recommends the lender ensure the borrower understands the risk. As noted, this is the type of information that should be communicated to potential homebuyers while they are shopping for a loan. A government brochure that explains this would be particularly useful for borrowers who are purchasing a condominium on an upper level of a multi-story building and who questions the need for flood insurance as an unnecessary expense.

The proposed guidance provides that if the condominium association lets its RCBAP coverage lapse, the lender must notify the borrower and ensure steps are taken to maintain coverage on the individual condominium (question 27). It is important, though, that the final guidance also incorporate recognition that there will be instances when the condominium association will not notify the borrower or the lender and through no fault of the parties to the loan transaction, coverage may lapse. While it is important that the parties to the loan should consider this, it is equally important they not be put into the position of having to constantly monitor and verify what the condominium association is doing.

Finally, the proposal would also offer details on how the co-insurance penalty applies in the case of a condominium (question 28) and examples on how the RCBAP and individual unit owner's coverage relate (question 29).

ICBA supports all of the added guidance for residential condominiums. In addition, ICBA encourages the agencies to extend this guidance to other types of condominiums such as office condominium developments which are becoming increasingly common.

Home Equity Loans, Lines of Credit, Subordinate Liens and Other Security Interests. The proposal would clarify that home equity loans are covered by the rules (question 30). It would also clarify that a draw under an existing line of credit does not require a separate determination of flood hazard (question 31).[8]

For a second mortgage, the lender must ensure adequate flood insurance is in place to cover the combined outstanding principal balance of both loans (question 32). Moreover, the second lien-holder must ensure there is adequate coverage for the total, not just the second loan. If the second lien-holder is the same as the first lien-holder, an additional flood hazard assessment may not be necessary depending on how recent the

[8] The determination would be made at the time the loan is originated, not for each draw.

determination was made for the first loan. However, if the second lien-holder is a different lender, a new flood hazard determination is required (question 33).

ICBA welcomes this additional guidance for subordinate liens but recommends that the final guidance clarify that these elements apply to all subordinate liens and not just home equity loans.

Inventory. If a loan is secured by inventory stored in a building located in an SFHA, the guidance would clarify that flood insurance is not required (question 34). But, if both the contents *and* the building secure the loan, then a flood hazard determination would be necessary (question 35).[9] Moreover, even if the security interest in a building or mobile home is taken in an "abundance of caution," because the loan is secured by covered property, the flood insurance rules apply (question 37).

ICBA finds this guidance appropriate.

Loan Secured by a Note or Guarantee. If the loan is secured by a note backed by a security interest in a building in an SFHA, the proposal would clarify that flood insurance is not required (question 38).[10] However, if the loan is backed by a guarantee secured by a building in an SFHA, flood insurance would be required (question 39).[11]

ICBA is concerned about this element of the guidance because it seems inconsistent and draws an arbitrary distinction between a loan secured by a note and one secured by a guarantee. It would seem more logical and less confusing to provide in the final guidance that when a security interest in a building supports the collateral for a loan, flood insurance is required. In other words, if the security interest – whether it is a promissory note or a guarantee – is backed by a building, the flood insurance rules apply. This would be consistent and less confusing than the approach outlined in the proposal.

<u>Participations and Syndications.</u>

The proposal would specify that each lender in a participation or syndication is responsible for ensuring the flood insurance rules are followed. In addition, the agencies expect participating lenders to have adequate controls in place to monitor the activities of the lead lender.

ICBA is concerned that this element of the proposal is inconsistent with the earlier guidance proposed for purchased loans. It is true that, from a safety and soundness perspective, each lender is ultimately responsible for the success of the loan and therefore should ensure that all regulations are followed, including flood insurance rules. Participating lenders, in the course of sound banking practices, should want to know the activities of the lead lender and if they determine that the loan is not secured by

[9] In other words, it is the security taken on the building that triggers the flood hazard determination.
[10] The distinction would be based on the fact that the collateral is the note and not the underlying property.
[11] Apparently, the difference is based on the premise that the property is integral to the guaranty but not a promissory note.

adequate flood insurance, then the participating lender should notify the lead lender of the inadequacy. Ultimately, all of the lenders are at risk and thus should be responsible for ensuring that flood insurance coverage is in place.

However, while the guidance would clarify that each lender in a participation or syndicate does not have to duplicate efforts, it seems inconsistent to have guidelines that require no verification for a 100% purchase of a loan but substantial verification for less than 100% purchase. The lead lender should be responsible for ensuring flood requirements are met and forward proof to participating lenders and it is the lead lender's responsibility to insure accurate documentation after our initial due diligence. As a matter of safety and soundness and general banking regulations, participants or members of a syndicate will conduct a due diligence investigation of the lead lender. It would therefore seem logical for the flood insurance guidelines to treat a purchase in a participation or syndicate the same as any other loan purchase. The relation between the lead lender and members of the participation or syndication should then be governed by other rules and regulations outside the flood insurance guidance.

Loan Sale or Transfer

If a lender sells or transfers a loan and the servicing rights, the lender must notify FEMA of the new servicer (question 41). The lender must also notify FEMA of the new servicer even if it only sells the servicing rights but still holds the loan. While the servicer will have compliance obligations under the loan, it is the lender who is ultimately liable.

Generally, ICBA agrees with this requirement since the risk of loss stays with the lender. However, ICBA also believes that it is appropriate to allow lenders to assign a certain level of responsibility to the servicer. As with participations and syndications, the lead lender should be responsible for conducting a certain level of due diligence in the relationship with the servicer outside and beyond the flood insurance requirements. For the purpose of the flood insurance guidelines, then, it should be acceptable to let the lender assign the responsibility through contractual arrangements with the servicer. This would not absolve the lender of liability and ultimate responsibility but would make for a less burdensome and more logical approach. Again, the relationship between the servicers and the lender would primarily be governed by other existing rules and regulations outside the flood insurance guidance, but the flood insurance guidance would permit the lender to assign a certain level of responsibility to the servicer.

The proposal would also provide that if a **lender makes and services the loan**, the borrower's purchase of flood insurance is sufficient notice to FEMA (question 42), and that if additional notice to FEMA is required, forwarding a copy of the RESPA Notice of Transfer will satisfy the requirement. **ICBA finds this helpful guidance**. It provides an avenue to ensure that FEMA is notified of who is servicing the loan and it clarifies what constitutes sufficient notice to FEMA. And, it keeps the process simple.

If the **lender sells both the loan and servicing rights**, the lender must notify FEMA (question 45). But, if the servicer transfers the servicing rights, the lender is not obligated to notify FEMA (question 46). Finally, if lender merges with another financial

institution, the duty to notify FEMA falls to the successor institution (question 47). As with the preceding paragraph, **ICBA finds this guidance helpful**.

Escrow Requirements

Multi-family buildings and mixed use properties are included in the definition of residential real estate properties subject to the flood insurance regulations.[12] If a lender requires an escrow account for taxes, hazard insurance or other loan charges, then the proposal would clarify that an escrow for flood insurance is also required (question 48). However, if the escrow account is voluntarily on the part of the borrower, an escrow for flood insurance is not necessary but the lender must be able to demonstrate the escrow is voluntary (question 49). Escrowed premiums for credit life of disability insurance are not escrow accounts that require the flood insurance escrow (question 51).

ICBA finds the guidelines on escrow requirements helpful. It provides a clear and straightforward explanation of when flood insurance premiums must be escrowed and also clarifies the distinction between required and voluntary escrows.

Forced Placement

A lender must force place flood insurance *if* the property is in an SFHA, existing flood insurance is inadequate, *and* after notice the borrower fails to purchase appropriate coverage.[13] A servicer can force place flood insurance on behalf of the lender. When forced placement occurs, the required coverage is the same as non-force placed flood insurance (question 56).

ICBA generally agrees with the guidance on force-placed insurance. To protect the bank, the borrower and the government, adequate flood insurance should be in place. The level of coverage required should not be affected by external events surrounding the manner in which the insurance was acquired. If a borrower fails to maintain adequate flood insurance, the bank should force place the insurance to protect all involved and it is appropriate for the borrower to incur the expense. However, both from a customer relations perspective and general fairness, the borrower should receive notification of the lapse of insurance and be afforded an opportunity to acquire insurance prior to force-placement since insurance the borrower acquires may be less expensive.

ICBA also urges the agencies to incorporate reasonableness into the final standard to allow community banks time to force place insurance once the 45 days have elapsed. It is important that the agencies – and examiners – recognize that it will take time to put the insurance in place. During that period, the bank's gap insurance can apply, but it is unreasonable to expect that force-placement can occur immediately at the end of the grace period. As long as the bank has appropriate procedures in place and is taking

[12] For mixed use property, the lender should consider the primary use of the property to determine if it meets the definition of residential real estate subject to the requirements. The regulation does not distinguish whether a building is single or multi-family or whether the building is owner-occupied or renter-occupied.

[13] The borrower has 45 days from the time of notice to purchase flood insurance coverage before the lender must force place.

proper steps to ensure that forced placement occurs in a timely manner that should be sufficient for compliance with the requirements.

Gap Insurance

The proposal would provide that a lender's gap insurance coverage is not a substitute for the borrower's flood insurance. Rather, the guidance would clarify that gap coverage should only a temporary solution for an inadvertent lapse.

ICBA agrees with this element of the proposal. Lenders' reliance on gap insurance would place an undue burden on the gap insurance carrier. Since the fundamental goal of flood insurance is to protect the borrower, and since gap insurance protects the bank and not the borrower, it fails to meet the fundamental underlying purpose for flood insurance requirements. Reliance on gap insurance as replacement coverage would serve as a disincentive to require borrowers to acquire flood insurance and would also likely cause premiums for gap insurance to increase. The guidance clarifies that gap insurance is a stopgap measure that should not be seen as a replacement for flood insurance and ICBA supports this approach.

Standard Flood Hazard Determination Form (SFHDF)

The proposal would provide that the SFHDF does not replace the borrower notification form (question 58). While a lender can give a borrower the SFHDF, that is not required (question 59). The SFHDF may be used in electronic format (question 60). And finally, a lender may relay on a previous determination *if* it is the same lender, the determination is no more than seven (7) years old, and there have been no flood map revisions or updates since the original determination.

ICBA finds this guidance useful.

Flood Determination Fees

The proposal would clarify that there are four instances when the lender can charge a fee to make a flood hazard determination: (1) in connection with making, increasing, extending or renewing a loan; (2) for a re-evaluation due to a change in a flood-risk zone; (3) if FEMA publishes a notice that affects the area where the security property is located; or (4) when a determination results in forced placement of insurance (question 62). In addition, a fee may be charged for life of loan reviews (question 63).

ICBA agrees with this guidance.

Flood Zone Discrepancies

If there is a discrepancy between the flood hazard designation on the form and on the flood insurance policy, the lender should have a process in place to identify and resolve the discrepancy (question 64).[14] Ultimately, though, the lender is responsible for the resolution of the discrepancy.

[14] The guidance would clarify that a discrepancy due to a grandfathered coverage is "reasonable and acceptable." In addition, where the discrepancy cannot easily be resolved, the lender and borrower can jointly ask FEMA to review the situation.

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While ICBA does not disagree with this guidance, we also have some concerns. **ICBA agrees that any discrepancies need to be corrected** to ensure the requisite flood insurance is maintained as well as be certain that a borrower is not forced to obtain flood insurance if the property is not in a flood plain. The customer also needs to know for sure whether the community in which the property is located participates in the flood insurance program. Each lender should work with the insurance provider and FEMA to verify the correct designation. Generally, the flood determination company used by the lender should have procedures in place to resolve discrepancies.

However, it is also important to acknowledge that mapping may not be clear or up-to-date. In addition, the guidance assumes that the discrepancy can be resolved by the lender when factors beyond the lender's control may be in play. Therefore, **ICBA recommends the final guidance address instances where the discrepancy cannot be resolved and acknowledge a lender's good faith efforts to resolve the discrepancy**. While the guidance does provide recourse for the borrower and the lender to apply to FEMA, it would also be helpful to include guidance for what steps should be taken while the parties are waiting for a final decision by FEMA.

Notice of Special Flood Hazards and Availability of Insurance

The guidelines would clarify that a lender is only required to provide notice to only one borrower on a loan, even where there is more than one borrower (question 66). Second, if a loan is secured by a mobile home but the location of the home is unknown at origination, the proposal would clarify that notice may be provided as soon as practical after it is determined the mobile home will be located in an SFHA (question 67). Finally, in all other instances, the lender must provide the notice at the time other loan information is provided (question 68).

In addition, the proposed guidance would provide that appropriate notice to a servicer would be a copy of the notice given to the borrower (question 69). Even if the servicer is affiliated with the lender, notice to the servicer is required (question 70). Moreover, a lender must maintain the record of receipt of the notice as long as the lender owns the loan (question 71). A lender cannot rely on a prior notice, even if it is less than 7 years old, even though it is the same property, same borrower and same lender (question 72). Finally, while the regulations offer a model form, use of the model is not mandatory, although if the model is not used the lender should be sure its notice includes all the information necessary for compliance with the statute and regulations (question 73).

ICBA finds these elements of the proposed guidance helpful.

Penalties

The proposal would clarify that a pattern or practice of violations of any of the following constitutes a violation subject to civil money penalties: failure to purchase available flood insurance; failure to escrow when required; failure to force place flood insurance when required; failure to provide notice, either to the borrower or servicer. Each violation is subject to a $385 fine, with a maximum annual ceiling of $125,000 (question 74). Although the statute does not define a pattern or practice, each agency

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make a determination on a case-by-case basis. Generally, the totality of the circumstances is considered when making such a determination (question 75).

Especially since flood insurance regulations penalties can quickly mount up, **ICBA supports this guidance since it helps clarify how the penalties apply**. ICBA encourages the agencies to continue to assess and provide clarity for lenders on what fact patterns represent a pattern or practice. In addition, ICBA recommends that the final guidance clarify that the assessment be based on an overall assessment of the loan portfolio and not randomly selected representations.

Conclusion

Overall, ICBA finds the proposed guidance helpful. Since the flood insurance rules can be both complex and confusing, ICBA welcomes any additional guidance the agencies can provide. We would also encourage the agencies to keep the guidelines regularly updated and not wait ten years before the next update. Regular updates offer two benefits: it ensures the guidance is current and it also serves as a reminder to the public of the requirements.

ICBA welcomes the additional information, including the illustrative examples, that helps lenders better understand the requirements. The proposal outlines answers to frequently asked questions in a straightforward manner and provides clarification. Generally, the proposed guidance seems consistent with current understanding of the requirements.

Thank you for the opportunity to comment. If you have any questions or would like additional information, please contact the undersigned by telephone at 202-659-8111 or by e-mail at robert.rowe@icba.org.

Sincerely,

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