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May 20, 2008

Mr. Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17th Street, N.W.  
Washington, D.C. 20429

Re: RIN No. 3064-ZA00--Loans in Areas Having Special Flood Hazards;  
Interagency Questions and Answers Regarding Flood Insurance

Dear Mr. Feldman:

On behalf of Aldrich & Bonnefin, PLC and our clients, we appreciate the opportunity to comment on the proposed Interagency Questions and Answers Regarding Flood Insurance (Proposed Q&As) issued by the federal banking agencies on March 21, 2008 (73 FR 15259). By way of background, Aldrich & Bonnefin, PLC (Law Firm) provides quality legal services to all levels of community banking and general business industries in California. One of the unique specialties the Law Firm offers is the resources of an in-house legal department to financial institutions, including banks, savings associations and credit unions that do not maintain a legal department.

### **The Law Firm's Position**

The Law Firm commends the banking agencies on its considered efforts to provide lenders and industry professionals with greater clarification on the applicability of the federal flood insurance regulations. We are supportive of the banking agencies' intent of providing additional resources to lenders that will assist in compliance with the federal flood insurance regulations and curtail further criticism and citation in this area. We also appreciate the significant amount of time and deliberation the banking agencies have invested in developing these proposed revisions. The Law Firm supports the goals and general approach of the Proposed Q&As, as well as the majority of the specific Q&As proposed.

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### **The Law Firm's Concerns**

We have two related concerns we'd like to discuss with the federal banking agencies. Primarily, we are concerned with the answer to Proposed Q&A #19, which addresses the timing for requiring evidence of flood insurance coverage on construction loans. On a related note, we are seeking clarification or a definition of loan closing to assist our clients in interpreting the requirements of the federal flood insurance regulations.

### **Proposed Q&A #19**

We have concerns about a particular question and answer discussed in proposed Section IV., Flood Insurance Requirements for Construction Loans, of the Proposed Q&As.

In particular, Proposed Q&A #19 attempts to provide greater flexibility when making a construction loan by allowing lenders to defer the purchase of flood insurance until a foundation slab has been poured and/or an elevation certificate has been issued. Feedback from our clients on Proposed Q&A #19 has been positive and our lenders appreciate the guidance and ability to defer evidence of flood insurance coverage on construction loans due to the difficulty in obtaining the insurance from flood insurance companies prior to closing. However, it is unclear to us how the receipt of an elevation certificate alone would act as a trigger requiring a lender to mandate evidence of flood insurance coverage.

As we understand it from the Federal Emergency Management Agency (FEMA), an elevation certificate serves the purpose of providing FEMA, insurance companies or other industry professionals with proof that a structure has been built in accordance with FEMA's flood plain management standards. In other words, an elevation certificate is documented evidence that the structure is elevated above the 100-year flood plain, resulting in minimized flood risk to that structure. Discussions with FEMA have revealed that it is not necessary for a slab to have been poured in order to obtain an elevation certificate. Thus, it appears that lenders opting to defer flood insurance coverage must remain focused on the date the slab has been poured before requiring evidence of flood insurance coverage from its construction loan borrower. While we understand that lenders have the option of requiring evidence of flood insurance at closing (and prior to the slab being poured), it would seem the alternative approach allowing for deferral of proof of flood insurance coverage would be dependent upon the pouring of the slab and not the receipt of an elevation certificate.

We are seeking clarification on Proposed Q&A #19 and perhaps the elimination of the reference to the elevation certificate, to lessen confusion for lenders seeking to defer evidence of flood insurance coverage until after closing when the slab has been poured.

### **Clarification of Loan Closing**

Finally, we would like to discuss an issue that appears to be causing great confusion for our clients and other lenders in the area of flood insurance. Our clients have expressed to us that they are experiencing difficulty with insurance companies that will not issue flood insurance policies on properties that are not owned by the borrowers. According to our clients, in purchase-money transactions, insurance companies do not consider the properties to be owned by the borrowers (and thus insurable) until escrow closes, the grant deed records, and the loan proceeds are disbursed, and will not cooperate before these events occur. As we understand it from our clients, more often than not, flood and fire insurance are the last items that are obtained before funding and are generally either satisfied through escrow or are furnished to the lender once the property has been recorded in the borrowers' names. As a result, lenders seem to be obtaining evidence of flood insurance prior to funding instead of having it in place when the first borrower signs the loan documents because, as they see it, signing the loan documents does not guarantee that the deal will close and record. Thus, in their eyes, "closing" does not occur until "funding."

We do not agree that loan "funding" is the equivalent of loan "closing." Section 339.3(a) of the flood regulations (12 CFR 339) provides the following: "A bank shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan." In other words, the loan must be covered by flood insurance when it is made, which is typically when the loan documents are signed. It is at that point that both parties (the borrower and the lender) are obligated on the loan, subject to whatever conditions subsequent have been imposed by the lender. On the other hand, "funding" and other escrow activities typically occur subsequent to loan closing (that is, after the legal obligation has been created).

Further, the FDIC's lending compliance examination procedures require examiners to ask the following question when reviewing loan files: If an improved property or mobilehome is located in a SFHA and flood insurance is required, does the institution have the borrower obtain a policy, with the institution as loss payee, in the correct amount prior to closing? Thus, the FDIC examiners appear to focus on ensuring a policy has been applied for or obtained prior to closing (which, as we see it, traditionally occurs upon loan signing).

Moreover, Section A.4.d. of the Mandatory Purchase of Flood Insurance Guidelines (as revised in September 2007) provides the following: A designated loan must have flood insurance as a condition of closing. If a borrower will not voluntarily obtain coverage, the lender must deny the loan. A lender cannot accept a borrower's assurance that he or she will obtain coverage in the future or grant the lender indemnity while he or she seeks coverage. Closing a designated loan without coverage in place constitutes a violation of the regulation.

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Finally, at the California Bankers Association's Regulatory Compliance Conference in October 2007 during one of the sessions on flood insurance, FEMA's representative commented that even in situations where the flood insurance premium is being paid out of escrow, borrowers must pay the first premium from other sources and seek reimbursement from escrow because waiting until proceeds are disbursed from escrow to show that the premium has been paid is too late (because it is after closing). Thus, FEMA appears to agree that closing occurs prior to loan proceeds being disbursed from escrow.

We wanted to take this opportunity to express our clients' concerns relating to the timing rules governing the requirement for evidence of flood insurance coverage. Perhaps the banking agencies could incorporate a discussion of loan closing into one of the Proposed Q&As or draft a new one that specifically deals with this issue. While we understand that the flood insurance regulations are not designed to take into account the practical realities associated with a lender's compliance responsibilities, we believe our clients would be greatly assisted by clarification to aid them as they develop procedures that work in conjunction with the regulatory requirements governing flood insurance.

### **Conclusion**

In closing, Aldrich & Bonnefin, PLC would like to thank the federal banking agencies for the opportunity to comment on the proposed Interagency Questions and Answers Regarding Flood Insurance. We appreciate your consideration of our suggested changes to the proposal, and support the banking agencies' efforts to provide lenders with additional resources to assist in compliance with the federal flood insurance regulations.

Very truly yours,

*Janet M. Bonnefin*

Janet M. Bonnefin

JMB:plr