International Bancshares Corporation

January 4, 2017

Via email Rulemaking Portal: www.regulations.gov

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Robert Feldman, Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Board of Governors of the Federal Reserve System, Docket No. R-1549, RIN 7100-AE60; Federal Deposit Insurance Corporation, 12 CFR Part 339, RIN 3064-AE50, *Loans in Areas Having Special Flood Hazards – Private Flood Insurance*

Ladies and Gentlemen:

The following comments are submitted on behalf of International Bancshares Corporation ("IBC"), a multi-bank financial holding company headquartered in Laredo, Texas. IBC holds five state nonmember banks serving Texas and Oklahoma. With over $12 billion in total consolidated assets, IBC is the largest Hispanic-owned financial holding company in the continental United States. IBC is a publicly-traded holding company. IBC's subsidiary banks make loans secured by improved real estate including residential properties as well as commercial ones. Several of its market areas (Houston and Brownsville) are subject to hurricane activity, with significant potential for flooding. Virtually all branches have loans with collateral in specially designated flood hazard zones. Flood insurance compliance is a significant issue for it, both in terms of regulatory risk and with regard to credit risk. Therefore, the changes contemplated by this proposal are critical to it and its customers. Ultimately, the flood program must be workable for all banks as well as the borrowers who are affected. We appreciate the opportunity to comment on the agencies' proposal.

On October 31, 2016, the Federal bank regulatory agencies requested comment on a joint notice of proposed rulemaking to implement provisions of the Biggert-Waters Flood Insurance Reform Act ("Biggert-Waters Act") that require regulated lending institutions to accept certain private flood insurance policies in addition to policies made available by the Federal Emergency Management Agency.[1]

[1] The federal flood insurance statutes require regulated lending institutions to ensure that flood insurance is purchased in connection with loans secured by improved real property located in areas having special flood hazards. Under the Biggert-Waters Act, regulated lenders must accept, in satisfaction of this

The proposed rule includes provisions to assist lending institutions in identifying private flood insurance policies they would be required to accept. The proposal also would clarify that lenders retain their discretion to accept private flood insurance policies that do not meet the criteria for mandatory acceptance, provided certain conditions are met.[2] The agencies previously issued a proposal addressing private flood insurance in October 2013.[3] Based on comments received in response to that proposal, the agencies have decided to issue this second proposal for additional public comment.

I. Comments

A. Generally

We limit our comments to the following two provisions of the agencies' proposal to lenders regarding how to accept private flood insurance: (i) A "compliance aid" to help consumers and lenders determine whether a particular private flood insurance policy is required to be accepted; and, (ii) For policies that do not meet the mandatory acceptance criteria, the rule includes guidance allowing lenders to exercise discretion in accepting policies as long as certain conditions are met.

The proposal includes a new provision that would *require* a regulated lending institution to accept a private flood insurance policy that meets both: (1) the statutory definition of "private flood insurance," and (2) the mandatory purchase requirement which provides that the coverage amount must at least equal 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 Biggert-Waters Act. Under the proposal's "compliance aid" provision, the *mandatory* acceptance criteria for private flood insurance has three components: (1) the policy has a written summary showing how the policy meets the definition of private flood insurance, including identification of the provisions of the policy that meet each criterion, and confirms that the insurer is regulated in conformity with the definition of private flood insurance; (2) the regulated lender verifies in writing that the policy includes the provisions identified by the insurer and that these provisions satisfy the criteria in the definition; and (3) the policy includes the following provisions either in the policy or in the endorsement: "This policy meets the definition of private flood insurances contained in 42 USC 4102a(b)(7) of the Biggert-Waters Act and the corresponding regulation."

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mandatory purchase requirement, policies issued by private insurers that satisfy the criteria specified in the Biggert-Waters Act.

[2] Furthermore, the proposed rule would establish criteria to apply in determining that coverage offered by a mutual aid society provides the type of policy or coverage that qualifies as "flood insurance" for purposes of the federal flood insurance laws.

[3] 78 FR 65107.

Under the proposal, the *discretionary* acceptance criteria for private flood insurance that does not meet the mandatory acceptance criteria, but does meet the following criteria: (1) the insurer is approved to engage in the insurance business by the insurance regulator of the state where the property is located; (2) the policy covers both the mortgagor and the mortgagee as loss payees; (3) the policy provides for cancellation after reasonable notice to the borrower in certain circumstances; and (4) the policy is either "at least as broad as" or otherwise "similar to" coverage provided under a standard flood insurance policy (the rules include guidance for determining what is "as broad as" or "similar to" a standard policy).

While we strongly support the agencies' efforts to encourage utilization of private flood insurance, particularly allowing lenders *discretionary* use of private flood insurance, we have serious remaining concerns as noted below.

B. *Continuing lack of manageable guidance to determine compliance will increase regulatory burden.*

Determining whether a proffered private policy meets the cloudy statutory and regulatory criteria will require all banks to conduct dozens or hundreds of case-by-case evaluations of issues that regularly give rise to litigation and frequently go to appellate courts for final decision. While the agencies' efforts to provide regulatory guidance are laudatory, there is still uncertainty as to private flood insurance.

Most banks do not possess the expertise to conduct this analysis, and obtaining it will require the hiring of additional specialists and/or reliance upon outside counsel to render opinions as to equivalence. To avoid these increased costs and criticism during an examination for having accepted a non-equivalent policy, most banks are likely to accept only National Flood Insurance Program ("NFIP") flood insurance policies. This creates a "lose-lose" situation during examinations if an examiner[4] feels that a private policy should have been accepted, especially in situations where it is determined that these issues are a Matter Requiring Attention or worse.

The proposal, while a significant improvement over the agencies' 2013 flood insurance proposal, does still not address these difficulties and should be withdrawn in their present form or redrafted in such a way as to provide all lenders and servicers, especially community banks, with better, more definitive, guidance on the scope of their discretion.

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4 It is unlikely that most examiners will have the specialized training or experience necessary to evaluate insurance coverage questions, especially "on the fly" during an examination.

C. There is no way for lenders or servicers to determine whether "private flood insurance" satisfies the requirements of 42 U.S.C. § 4012a(b)(7)(B) of the Biggert-Waters Act or the proposed regulation.

The proposal requires regulated lending institutions to accept "private flood insurance" as defined in the proposed regulation (Section 339.2(k)). The proposal requires regulated lenders to accept "private flood insurance" that provides flood insurance coverage which is at least as broad as the coverage provided under a standard flood insurance policy under the national flood insurance program, including when considering deductibles, exclusions, and conditions offered by the insurer.

It is virtually impossible for a lender or servicer to determine whether "private flood insurance" as defined in this section will provide coverage "at least as broad" as private flood coverage, particularly in light of deductibles and other provisions generally used in private insurance. This is particularly true with respect to commercial property insurance outside of the NFIP program. As a result, in order to avoid regulatory difficulties, lenders and servicers are unlikely to accept "private flood insurance" under any circumstances.

There are multiple issues for lenders and servicers to consider, including:

1. ***Remaining differences in policy format.*** All NFIP policies provide coverage for "direct physical loss by or from flood," which is specifically defined in the NFIP policy form. We are unaware of any privately issued non-Write-Your-Own ("WYO") NFIP property insurance form that defines "flood," and relevant case law[5] strongly suggests that the lack of definition will give rise to significant variations between policies and litigation as to the scope of coverage.

Where the borrower relies on a portfolio policy – that is, a policy providing coverage for multiple buildings or locations[6] -- issues can arise as to whether coverage is "specific insurance" with limits specific to a particular building or location or whether limits can be aggregated so as to increase amounts available to cover losses as any particular losses. Issues with respect to whether limits or sublimits applicable to flood coverage may be aggregated (or whether aggregates have been exhausted) creates the possibility for litigation when a claim arises and for disputes with examiners over whether coverage is adequate.

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5 *See In re Katrina Canal Breaches Lit.,* 495 F.3d 191, 210-11 (5th Cir. 2007)(discussion of definition of "flood" in context of flood exclusion in various policies).

6 *See ARM Props. Mgmt. Group v. RSUI Indem. Co.,* 400 Fed. Appx. 938, 940 (5rth Cir. 2010)(discussing dispute over extent of coverage under interlocking policies covering at least nine apartment complexes damaged in Hurricane Katrina).

2. ***Remaining issues with respect to deductibles.*** Although the maximum optional deductible for NFIP flood insurance is $50,000, most NFIP policies have substantially lower deductibles. Such is not the case with non-NFIP flood insurance. Many homeowners' policies and commercial property policies have substantially higher deductibles than are allowed for NFIP coverage. Moreover, most private property insurance policies now contain Named Storm Deductible Endorsements that raise the deductible amount from a flat sum for to a percentage deductible (sometimes as high as ten percent) that is assessed separately on each building or structure.[7] Named Storm Deductibles apply to hurricanes and similar flood-generating events and are inconsistent with the purpose and structure of NFIP deductibles.

3. ***Exclusions in private policies are materially more restrictive.*** NFIP flood insurance policies cover "direct physical loss by or from flood," and do not appear to contain an anti-concurrent causation clause ["ACC"]. ACCs appear in virtually every private property insurance policy and materially limit coverage, depending upon the circumstances.[8] The NFIP policy does not contain an ACC.

4. ***Lack of timely access to policies.*** To be workable, a lender or servicer must have timely access to the terms of the private policy in order to determine whether the private policy meets the equivalence requirements in the statute. Currently, the FEMA NFIP Flood Insurance Manual requires lenders to accept "copy of the Flood Insurance Application and premium payment, or a copy of the declarations page" as evidence of proof of flood insurance. Binders are not accepted, and forms such as the ACORD 29 are accepted "for informational purposes only."[9]

This structure is workable only because the relevant policy forms for NFIP policies are immediately available on line. This is not the case in the private policy arena, however, where there often is a substantial delay between the binding of coverage and actual delivery of a policy.[10]

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7 *See* http://www.naic.org/cipr_topics/topic_named_store_deductibles.htm.

8 *Stewart Enterprises Inc. v. RSUI Indem. Co.,* 614 F.3d 117, 126 (5th Cir. 2010)("ACC clauses permit parties to contract around common-law causation rules, such as efficient proximate causation. Under this causation rule, an insured may recover for damage caused jointly by an included and excluded peril if the included peril is the dominant and efficient cause of the loss.").

9 NFIP Flood Insurance Manual, "General Rules," at 15.

10 *See, e.g., McClaff, Inc. v. Arch Ins. Co.,* 978 So.2d 48 (La. App. 3d Cir. 2008)(binder issued October 14, 2002, policy February 2003; four months); *Trident Seafoods Corp. v. Commonwealth Ins. Co.,* 850 F. Supp. 2d 1189 (W. D. Wash. 2012)(binder issued December 2007, policy issued June 2008; six months); *Stuart v. Pittman,* 235 Or. App. 196, 230 P.3d 958 (2010), *rev'd,* 350 Or. 410, 255 P.3d 482 (2011)(binder dated September 1, 2003, policy issued in March 2004; seven months); *Conklin v. Hanover Ins. Co.,* 2007 WL 763271 (E.D. La. 2007)(binder issued in May, policy issued in December;

This is not necessarily a problem at loan formation, because disbursement of funds can be delayed until the policy is received and found to be compliant. After loan closing, however, funds cannot be "un-disbursed." Any significant delay in obtaining policies to review creates the possibility for conflict and litigation between a borrower, who will believe that they are in compliance by having tried to obtain a private policy, and a lender, who cannot make a determination as to compliance because the policy has not been delivered. As a result, the lender must force place because at that point coverage is "inadequate or does not exist."

D. Proposal creates the potential for conflict with state law regulating insurance.

NFIP flood insurance enjoys the protections of sovereign immunity, which results in substantial limitations on the rights of insureds.[11] In the absence of a sovereign link to the federal treasury, however, the justification for short limitations periods and strict interpretation of deadlines vanishes. The proposed regulation should make clear that "private" flood insurance not backed by the federal treasury is governed by solely by applicable state law, including statutes of limitations and other substantive requirements.

In Texas, there are two areas are of particular concern: (1) the one-year limitations period, and (2) policy cancellation. As to the first, § 16.070 of the Texas Civil Practice and Remedies Code allows contractual limitation periods provided that they are at least than two years in length; shorter limitation periods are void.[12] As to the second, Chapter 551 of the Texas Insurance Code and 28 T.A.C. 5.7001 *et seq.* impose restrictions upon the circumstances and manner in which insurers may cancel or decline to renew various property insurance policies. Other states have similar statutes and/or regulations.

Neither 42 U.S.C. § 4012a(b)(7)(C) of the Biggert-Waters Act nor the proposal should be implemented so as to require a lender to accept a purely "private" flood insurance policy whose provisions are contrary to controlling state law.[13]

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seven months); *Residential Constructors LLC v. ACE Prop. & Cas. Co.,* 2006 WL 3149362 (D. Nev. 2006)(allegations that binder was issued in January and policy in October; ten months).

11 *See, e.g., Jokumsen v. FEMA,* 2013 WL 3716436, slip op. at *4 - *5 (D. Neb., July 11, 2013)(limitations period); *Richardson v. American Bankers Ins. Co. of Fla.,* 279 Fed. Appx. 285 (5th Cir. 2008)(deadline for submission of claims); *Marseilles Condo. Homeowners Ass'n v. Fidelity Nat. Ins. Co.,* 542 F.3d 1053, 1056 (5th Cir. 2008)(waiver of policy provisions); *Gallup v. Omaha Prop. & Cas. Ins. Co.,* 434 F.3d 341, 344-45 (5th Cir. 2004)(preemption of state bad faith and unfair claims practices law); *Robinson v. Nationwide Ins. Co.,* 2013 WL 686352 (E.D. Pa., February 26, 2013)(no right of jury trial on NFIP claim).

12 The general limitation period for a contractual claim in Texas is four years. *See* § 16.004, TEX. CIV. PRAC. & REM. CODE.

13 It may be argued that a lender should accept a federally compliant policy despite the presence of a provision void under state law because any conflict will be resolved in litigation, ultimately resulting in

II. Concluding remarks.

Virtually all of the proposed rules require the exercise of judgment by regulated lenders. Because of the continuing lack of bright line standards contained in the rule, a regulated lender's decisions as to flood insurance are uniquely susceptible to second-guessing during examinations. As a result, many lenders will be extremely reluctant to accept private flood insurance policies instead of NFIP based policies. Similarly, the proposed rules contain numerous pitfalls and ambiguities that make their implementation by lenders and servicers more difficult. It clearly was not the intent of the agencies to do this but the proposed rules should be withdrawn until a better and more straightforward set of standards can be drawn.

Thank you for your consideration.

Respectfully,

Dennis E. Nixon
President
International Bancshares Corporation

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claim payment and collateral protection. Lenders and borrowers should not be forced to bear the costs of resolving conflicts between the Biggert-Waters Act and controlling state law.