South Carolina Bankers Association

December 10, 2013

By electronic delivery to:

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Re: Loans in Areas Having Special Flood Hazards; RIN 1557-AD67; RIN 7100AE-00; RIN 3064-AE03; RIN 3052-AC93; RIN 3133-AE18

Ladies and Gentlemen:

On behalf of its 83 member banks, the South Carolina Bankers Association (SCBA) submits this comment letter to the proposal by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the National Credit Union Administration (the Agencies) to amend their respective regulations regarding loans in areas having special flood hazards to implement provisions of the Biggert-Waters Flood Insurance Reform Act.

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SCBA appreciates the opportunity to submit this letter and, by reference, endorses the American Bankers Association comment letter submitted December 6, 2013. SCBA's letter focuses on the following issues involving escrow and private insurance.

Exclusion of Loans that are Extensions of Credit for Business, Commercial or Agricultural Purposes

SCBA supports the Agencies' exclusion from the escrow requirement any loan that is an extension of credit primarily for business, commercial, or agricultural purposes, even if it is secured by residential property located in a flood zone. On January 14, 2013, Congress passed a technical correction to clarify that the flood insurance escrow requirement applies only to loans secured by "residential improved real estate." What is more, there is no evidence that Congress intend to extend the mandatory escrow requirement to commercial or agricultural purpose loans secured by residential improved real estate.

Typically, commercial or agricultural operations are small businesses and imposing such a mandatory escrow requirement would present significant operational and practical challenges on these businesses, such as:

- Requiring escrow would mean that capital that should be used to grow the small business or farm will be tied up in an escrow account;
- Flexibility in payment and loan structure would be limited by escrow collection requirements; and,
- Requiring escrow may result in misplaced responsibility for the payment of flood insurance premiums. Commercial purpose loans may have residential collateral pledged to a transaction, but only one of the business owners/borrowers may own the residence being pledged. In this situation, collection of escrow payments during the monthly billing cycle would make the business (i.e., all of the owners) responsible for paying the escrow, transferring flood insurance liability from the owner of the home to the entire business.

Exclusions for Subordinate Liens

SCBA supports the Agencies' proposed exclusion for subordinate liens when a lender has determined at origination of the subordinate lien that a borrower has obtained flood insurance that satisfies the mandatory purchase requirement and is currently paying flood insurance premiums and fees into an escrow account that has been established by the first lienholder. The senior lienholder is responsible for the receipt and payment of the flood insurance and it is not practical for both lenders to be involved in escrowing, receiving invoices, and paying premiums. In most instances doing so would result in double escrow payments—an unfair financial burden to the borrower and one that will be increasingly difficult for borrowers as flood insurance premiums rise to reflect actuarial rates.

However, SCBA asks the Agencies to reconsider the following statement,

> *If the first lienholder is not required to or otherwise does not escrow flood insurance premiums and fees for adequate insurance coverage ... the proposed rule would require the regulated lending institution in the second lienholder position to escrow required flood insurance premiums and fees, unless such regulated lending institution qualifies for an exception from the escrowing provisions.*

The mandatory purchase obligation requires action by a lender only at specific statutory triggers - when a loan is originated, increased, extended or renewed. Without clear direction by Congress, the Agencies should not seek to expand this obligation by imposing on a subordinate lienholder an ongoing duty to monitor whether (1) the first lienholder is collecting escrow payments from the borrower, (2) the first lien has been paid off, or (3) the first lienholder is exempt from the escrow requirement. Imposing such an obligation would increase origination and servicing costs significantly – costs that will ultimately be borne by consumers – without advancing the Congressional goal of ensuring that borrowers maintain flood insurance over the life of their loan.

Collection of Escrow

The Agencies' proposal suggests a staggered implementation process based on the renewal date of a flood insurance policy. It requires lenders to begin escrowing with the first loan payment after the first renewal date of the borrower's flood insurance policy that occurs on or after July 6, 2014. However, this staggered implementation timeline fails to address significant contractual, enforcement, and customer relation issues presented by the requirement to extend escrow to existing loans.

Under the proposed timing rule, a borrower who has just paid a full year's renewal premium will be expected to begin escrow on the first of the next month. Thus, the borrower will be required to pay a full renewal premium plus 1/12 of the next year's premium, *and* may also be asked to pay an additional one to two escrow payments to establish the reserve or cushion permitted by RESPA and state law. Many customers will struggle to meet this obligation, particularly as flood insurance premiums rise.

If customers struggle with, and even resist, paying the premiums, then there are questions about how lenders will enforce the collection obligation.

- Will lenders be expected to force place a policy and establish escrow for that force placed policy?
- If so, will the lender be expected to advance the necessary funds into an escrow account and charge the customer?
- Receipt of an insufficient monthly payment from a customer unwilling to escrow would constitute a default, but should lenders proceed with foreclosure for the sole purpose of complying with the rule?

SCBA recommends adoption of a rule that ties this obligation to a statutory tripwire – making, increasing, renewing, or extending a loan. Such a rule would minimize contractual, enforcement, and customer relation challenges. Further, the lender will not be put in the difficult position of denying an existing customer's contractual right not to escrow and then force placing insurance on that customer.

Private Insurance

The Biggert-Waters Act requires lenders to accept private policies that meet certain specific standards, including coverage at least as broad as coverage provided by a standard flood insurance policy (SFIP) under the NFIP. Few lenders have the capacity to determine whether policies meet the required standards, and others report that the private policies they receive today do not precisely meet one or more of these rigid criteria. The Agencies have proposed one potential solution to this problem: a safe harbor provision.

SCBA supports the proposed safe harbor, with suggested modifications. The Agencies' proposal permits a lender to rely upon the expertise of state insurance authorities to make the determination that the terms of a particular policy are consistent with the statutory definition of private flood insurance. However, no such mechanism exists today in South Carolina to make such a determination. Further, if South Carolina does develop such a mechanism, it may not be implemented in the same manner as in other states. Therefore, SCBA recommends that the Agencies modify the proposed safe harbor by creating an additional, or alternative, path to a safe harbor based upon a certification issued by the insurer issuing the private policy.

The regulation should permit a lender to accept a private flood insurance policy that does not meet the definition of private flood insurance, but which, in the opinion of the lender, would meet the mandatory purchase obligation of the FDPA. This provides lenders the flexibility either to rely upon a regulatory safe harbor, or to have the discretion to accept a private flood policy that does not fit within either safe harbor.

Conclusion

Again, SCBA appreciates the opportunity to submit this letter. Please let us know if there are questions.

With kind regards,

A. O'Neil Rashley, Jr.
Senior Vice President and Counsel