MBa

MORTGAGE BANKERS ASSOCIATION

December 10, 2013

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218, Mail Stop 9W-11
Washington, DC
20219
RIN 1557–AD67

Robert deV. Frierson, Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue,
NW Washington, DC 20551
Docket No. R-1462; RIN 7100 AE-00

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC
20429
RIN 3064–AE03

Barry F. Mardock, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102–5090
RIN 3052–AC93

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428
RIN 3133-AE18

Re: Joint Notice of Proposed Rulemaking on Loans in Areas Having Special Flood Hazards

Dear Sir or Madam:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on the joint proposed rulemaking[2] (the Proposal) of the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, the Farm Credit Administration, and the National Credit Union Administration (collectively, the Agencies) amending regulations regarding loans in

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans.MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] 78 Fed. Reg. 65108 (October 30, 2013).

areas having special flood hazards to implement provisions of the Biggert-Waters Flood Insurance Reform Act of 2012[3] (the Act).

BACKGROUND

Congress enacted the Act to ensure the continued financial sustainability of the National Flood Insurance Program (NFIP). The Act made a number of broad reforms to the NFIP to achieve this goal, including the implementation of ongoing escrow requirements for 1-4 unit (single-family) residential properties for certain regulated lending institutions and provisions intended to encourage greater private insurer participation in the flood insurance market. MBA supports the NFIP's goals and submits the following comments to ensure the appropriate implementation of the proposed regulations. In the rule-specific comments below, we first address 1-4 unit residential issues and then addresses separately the commercial/multifamily elements of the Proposal.

SUMMARY OF RECOMMENDATIONS

MBA's 1-4 unit residential primary observations and recommendations are summarized below:

- **NFIP and Private Flood Insurance Policy Language** - We examine the practical challenges of how a bank would make the determination if a private flood insurance policy would be "at least as broad" as a NFIP policy. We also express serious concern with proposed mandates to accept certain policies in all instances.

- **Safe Harbor** – We review problems with the proposed state insurance regulator based safe harbor provision, and provide an alternative safe harbor approach that calls for insurers to certify that their private insurance policies are "at least as broad" as the NFIP policies.

- **Escrow Requirement** – We strongly recommend that the Agencies require escrow only for loans in first-lien position and only on a "go-forward" basis, when a regulated lender makes, increases, renews, or extends a designated loan. The escrow rule should also expressly exclude loans on manufactured homes with a chattel mortgage and non-performing residential mortgage lines and loans that have been charged-off, are in bankruptcy, or are in foreclosure. The Agencies should also support the continuation of the current process to list junior lien holders on flood insurance policies as mortgagees as an alternative to mandating flood insurance escrow accounts on subordinate lien loans.

- **Escrow Timing** - In the event the Agencies require escrow on outstanding loans, MBA recommends a clarification that would prevent unnecessary escrow shortages and duplicate escrow payments.

[3] Public Law 112-141, 126 Stat. 916 (2012).

- **Escrow Notice –** We request confirmation that the notice timeframes begin on July 6, 2014, and that lenders may, but are not required to, send notices prior to that date.

- **Escrow and Changes in Ownership –** We request additional clarification of the Proposal's impact on common servicing scenarios, such as the transfer of mortgage servicing rights.

- **Sufficiency of Demonstration** – We express concern regarding affirmative requirements to accept declaration pages as confirmation of the existence of coverage and request clarification regarding the sufficiency of evidence of insurance coverage. We also request the Agencies confirm that there are circumstances in which a lender may accept alternative evidence of insurance documents to cancel force-placed insurance.

MBA's Commercial/Multifamily primary observations and recommendations are summarized below:

- **NFIP and Private Flood Insurance Policy Language** - We examine the practical challenges with how a bank would make the determination if a private flood insurance policy would be "at least as broad" as a NFIP policy. MBA urges for the Proposal to be modified to allow banks to have the flexibility to set financial requirements for an insurance company providing private flood insurance that is in conformity with the bank's safety and soundness standards.

- **Safe Harbor** - After examining the problems with the safe harbor provision that makes it unworkable, we provide an alternative safe harbor approach that calls for insurers to certify that their private insurance policies are "at least as broad" as the NFIP policies**.**

- **Escrow Exclusion for Multifamily Mortgages** – MBA strongly supports the Proposal's exclusion of over 4 unit multifamily mortgages from the escrow requirement.

- **Refunds for Force-Placed Flood Insurance** - The Agencies should withdraw this requirement as to existing loans and allow a substantial period for compliance prospectively and clarify that the lender's refund obligation is subject to the insurer's refund of the premium.

- **Sufficiency of Demonstration -** To help ensure the adequacy of the information a lender receives prior to acceptance, MBA recommends that the Agencies clarify that sufficient evidence of insurance coverage must include items specified in FEMA Bulletin W – 13013.

SINGLE-FAMILY (1-4 UNIT) RULE-SPECIFIC COMMENTS

1. Definitions

The Proposal adds a new definition for "private flood insurance" (Definition) which includes seven different provisions. MBA is concerned that the Definition may be overbroad and could unintentionally frustrate Congressional intent by limiting the ability of lenders to accept private flood insurance policies. The Definition requires that coverage be "at least as broad as" coverage provided by a standard flood insurance policy (SFIP) under the NFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. It will be very difficult for lenders to determine whether a private policy is "at least as broad" as SFIP coverage, as even minor deviations in policy language could be construed as failing to provide coverage "at least as broad."

Lenders will not typically have the type or number of insurance experts on staff to analyze the particulars of private flood policies in every instance. This is particularly true for smaller lenders, as hiring staff with such expertise would be extremely expensive, especially if the terms and conditions of private flood policies vary from state to state. Further, lenders often do not receive complete policies at closing, so even if the expert is available, there may be no means for the necessary review. In a typical closing, only an application with evidence of premium payment, the declaration page, or certificate of insurance would be available. None of those documents has the level of detail necessary for an expert to certify a private insurance policy as meeting the Definition. Given the additional costs, likelihood of delay, and the complexity of the decision making process, most lenders will be forced to deny all private flood insurance, frustrating borrowers and the intent of the law.

Even if the necessary documentation and expertise are available, the uncertainty related to determining if a policy is "at least as broad as" NFIP will make the widespread acceptance of private flood insurance unlikely. For example, a private flood insurance policy may include a policy limit that is higher than that found in the NFIP, but would also include a corresponding higher deductible. It is unclear whether that policy would qualify under the Definition, and given the potential liability for a lender associated with non-compliance, it is likely that most in the mortgage industry would interpret such a policy as not meeting the Definition.

Private flood insurance policies also typically include an aggregate limit detailing the maximum coverage amount payable in the policy term, which does not appear to be anticipated within the Definition. Requiring the removal of aggregate limits in private policies will be a major change and may not be acceptable to private flood insurance providers. The requirement to provide 45 days written notice of cancellation or non-renewal of flood insurance coverage is similarly problematic. Very few private flood policies require this type of notice, meaning that lenders would be unable to accept private flood policies going forward, including those policies lenders have historically considered acceptable.

2. Requirement to purchase flood insurance where available

Private flood insurance

The Proposal amends this section to require that all regulated lending institutions accept private flood insurance that meets the Definition. MBA is concerned about requirements that would broadly require lenders to accept private flood insurance policies without consideration of the particular situation, unique characteristics of the collateral, or other aspects of the policy. MBA strongly supports providing lenders with the discretion to accept private policies - as is the case currently - but we suggest mandates to accept private policies, even those that are inadequate, present exposure for borrowers and mortgage lenders and are inappropriate. The Agencies should not require a lender to automatically accept such a policy without any ability to ensure the specific flood exposures of that particular location or collateral are adequately addressed. Such mandates will hinder the growth of an effective, stable private flood insurance market, resulting in lesser flood protection and ultimately harming borrowers.

MBA applauds the Agencies for recognizing the problems inherent in requiring regulated lending institutions to evaluate whether a private flood insurance policy meets the Definition. Such a requirement would be a significant burden for lenders, since the process to review a private flood insurance policy is highly subjective, typically requires several weeks, and calls for expertise not typically associated with lenders.

In recognition of those concerns, the Proposal provides for a safe harbor based upon a state insurance regulator making a written determination that a flood insurance policy meets the Definition. While MBA strongly supports the creation of safe harbor provisions to encourage the private insurance market, we are concerned that relying solely on state regulators will be of limited utility. State insurance regulators will have varying levels of capacity and authority to make such a determination. It is also unclear whether state insurance regulators will be comfortable making determinations regarding federal laws, since their area of expertise is, by definition, at the state level. State insurance regulators must also abide by their own state requirements, which may conflict with NFIP requirements or require the inclusion of provisions that could cause policies to fail to meet the "at least as broad as" requirement.

State regulators will also face the same concerns as lenders in ascertaining the meaning of "as least as broad as." Consequently, it is highly likely that regulators in different states will come to different conclusions, even for identical policies. This would greatly hinder the acceptance of private flood insurance policies, including policies that cross state lines or provide flood insurance coverage on multiple properties in multiple states. It is also unclear whether there is a process anticipated which would ensure the participation of regulators in every state. Inconsistent participation will greatly complicate the process, raise costs, frustrate borrowers, and ultimately reduce the likelihood of private policy acceptance. This would be especially problematic for lenders that have multistate lending operations in which there was potentially conflicting state guidance on identical policy language. State insurance regulators are also unlikely to be in a position to provide a functional safe harbor solution for surplus lines insurance.

Surplus lines insurance is critical to the flood insurance industry because of concentration issues and high loss probabilities. Since surplus lines insurance carriers are generally not subject to state regulatory review, an important number of private flood insurance policies will not be afforded safe harbor protections. Standards that vary across state lines and omit important portions of the market will greatly increase the costs and complications associated with accepting private flood insurance policies, and reduce the likelihood that smaller lenders will have the capacity to put policies and procedures in place that allow them to regularly accept private flood insurance.

MBA strongly urges the Agencies to consider an additional safe harbor if an insurer certifies that their policy meets the criteria set forth in the Definition. As envisioned by MBA, a lender would be able to accept an insurer's endorsement on a policy or confirmation via a cover letter confirming that the policy was compliant with the mandatory purchase requirement of the Flood Disaster Protection Act (FDPA). This would put the burden for certification on the insurance industry, the group most qualified to do the coverage review and investigations necessary to certify policies.

Such a self-certification process would add very little risk, as private insurers would be contractually obligated to ensure their policies met the FDPA requirements. Self-certification would also largely mirror the larger hazard insurance market, and greatly increase the likelihood of acceptance of private flood insurance.

The Proposal also expressly permits regulated lending institutions to accept a flood insurance policy issued by a private insurer that does not meet the Definition. MBA strongly agrees that clear guidance from the Agencies detailing that such insurance may be accepted will effectuate Congressional intent by encouraging the growth of the private flood insurance market. As detailed above, MBA is concerned that requiring lenders to accept only private flood insurance that meets the Definition could effectively render most private flood policies unacceptable, since even minor deviations could be considered to not provide coverage "at least as broad" as NFIP coverage. Requiring that lenders only accept policies that meet the Definition could also significantly delay the acceptance of private flood insurance policies. Such delays could result in the unnecessary force placement of flood insurance, and delay the refunding of force-placed premiums. Current industry standards allow for the acceptance of private flood insurance policies not meeting the Definition. MBA is unaware of any widespread problems associated with this process and strongly encourages the Agencies to allow this to continue. This will reduce costs and encourage the acceptance of private flood insurance.

The Proposal also requests comment on whether the rule should base the acceptance of so-called "discretionary" private flood insurance policies that do not meet the Definition on three criteria: approval of state insurance regulators, coverage at least as broad as coverage provided by a SFIP under the NFIP, and inclusion of a mortgage interest clause similar to that contained in a SFIP.

Limiting acceptance upon the approval of state insurance regulators would restrict acceptable policies to either: those issued by an insurer that is licensed, admitted, or

otherwise approved to engage in the business of insurance in the state or jurisdiction in which the insured building is located by the insurance regulator of the state; or those issued by an insurance provider recognized or not disapproved as a surplus lines insurer by the insurance regulator of the state or jurisdiction where the property to be insured is located. Lenders do not maintain lists of insurers that are licensed, admitted, or otherwise approved in every state and jurisdiction, nor do lenders maintain a log of surplus lines insurance companies that are recognized or not disapproved by state insurance regulators. Instead, lenders routinely rely upon the A.M. Best financial strength rating of the insurer for hazard coverage, a financial health assessment of an insurer that has served the lending industry for years. MBA suggests that this process has worked for hazard coverage and will also work for private flood policies. Additional guidance requiring that the lender confirm the private insurer's approval will unnecessarily burden lenders and insurance agents and add little value for borrowers.

As addressed above in MBA's comments on the proposed definition of "private flood insurance," lenders would be significantly burdened by a requirement to determine that coverage is at least as broad as the coverage provided by a SFIP under the NFIP. To the extent the Agencies consider it critical that a private policy provide flood insurance that is "at least as broad as" the SFIP from the NFIP, the final rule should clearly state the process lenders should utilize when accepting a private flood insurance policy, recognizing the inherent difficulties and limited flood policy documentation available during a typical closing or policy renewal. MBA again strongly encourages the Agencies to allow insurers to self-certify that their policy satisfies the mandatory purchase requirement of the FDPA and to clearly provide a safe harbor to lenders that rely on such certification.

The Proposal requests comment on whether they should require any "discretionary" private insurance policy to include a mortgage interest clause similar to the clause contained in a SFIP. While MBA recognizes the ultimate goal of the potential requirement, we are unclear as to how this provision would be enforced. Instead, the Agencies should grant the insurer the authority to self-certify that their policy satisfies the mandatory purchase requirement of the FDPA. The lender, in turn, should be granted a safe harbor if they accept such an endorsement.

MBA reiterates its support for a solution that allows lenders discretion to accept private flood insurance that does not meet the Definition, but which provides flood insurance coverage that meets the mandatory purchase requirement of the FDPA. But we are concerned that these proposed criteria would have the effect of stifling the acceptance of private flood insurance. MBA encourages the Agencies to consider a solution that places the burden of demonstrating compliance on the parties most logically able to bear it, the insurers themselves. Such a solution will reduce costs and encourage the growth of the private insurance market, achieving the goals of Congress.

3. Single-family (1-4 unit) residential escrow requirement

In general

The Agencies propose to revise their regulations to require regulated lending institutions, or servicers acting on their behalf, to escrow all premiums and fees for flood insurance required for any loans secured by 1-4 unit residential improved real estate or a mobile home unless the lending institutions qualify for the statutory exemption. These proposed provisions would apply to any loan secured by 1-4 unit residential improved real estate or a mobile home that is made or is outstanding on or after July 6, 2014. MBA strongly supports the Agencies' recognition that these escrow requirements were only meant to apply to 1-4 unit residential loans and that commercial loans (including residential properties with 5 or more units) should be excluded. MBA appreciates the Agencies recognition of the NFIP technical corrections legislation[4] that limited the applicability of the escrow requirement to "residential" properties that clearly exclude multifamily loans with more than 4 units.

MBA is greatly concerned that the proposed requirement to escrow for outstanding loans will be unworkable in practice, leading to a host of problems for lenders and borrowers. The industry strongly recommends that the Agencies require escrow only for loans in first-lien position and only on a "go-forward" basis, when a regulated lender makes, increases, renews, or extends (a "MIRE event") a designated loan. While lenders may have the authority to require escrow on outstanding first-lien mortgages that were made using a uniform security agreement, the risk of borrower confusion and frustration when an escrow is suddenly mandated on an existing, performing loan is very high. In first mortgage situations, borrowers have typically paid a premium in exchange for receiving a written escrow waiver from the lender at origination eliminating the requirement to escrow for taxes and insurance. The proposed rule will place lenders in the untenable position of having to go back and require that same borrower to now establish an escrow account. Such a requirement may subject the lender to litigation risk and may violate state law regarding timing of notices and disclosures for changes in payment amounts. Further, many older loan documents have no escrow language included in them and would not allow the lender to require an escrow for any purpose.

Congress recognized that not all loans should be required to establish an escrow account in the Act by modifying Section 1308 of the National Flood Insurance Act of 1968 (42 U.S.C. 4015) as follows:

> *Section 1308 of the National Flood Insurance Act of 1968 (42 U.S.C. 4015) is amended by adding at the end the following:*
>
> *'(g) FREQUENCY OF PREMIUM COLLECTION.—With respect to any chargeable premium rate prescribed under this section, the Administrator shall provide policyholders that are not required to escrow their premiums and fees for flood insurance as set forth under section 102 of the Flood Disaster Protection*

[4] Public Law 112-281, 126 Stat. 2485 (January 14, 2013).

Act of 1973 (42 U.S.C.4012a) with the option of paying their premiums either annually or in more frequent installments.

Congress directly contemplated and established an option for non-escrowed NFIP policyholders to pay their NFIP premium in installments, rather than by establishing escrow accounts.

MBA supports the Agencies' position that a regulated lending institution need not establish a second escrow account when it determines at loan origination that a senior lender has already established an escrow account, or is an exempt institution. MBA believes the Agencies correctly understand the current process, and that the proposed rule enumerates the reasons why a second escrow account would be unnecessary. However, MBA has significant concerns with the additional proposal to require lien holders in a junior position to escrow funds in certain circumstances and believes this requirement will be unworkable in practice. Lenders in a junior position will not typically have a view into the escrow status of an unaffiliated senior lien. Consequently, lenders will be forced to establish escrow, often unnecessarily, unless they receive positive confirmation that escrow has already been established by the senior lien holder.

Investigating escrows on an ongoing basis represents a significant outlay of resources for lenders and will be unworkable in practice. MBA is unaware of any "clearinghouse" or other means of monitoring whether the first lien holder is escrowing, nor of any means of enforcing such an analysis against either the first lien holder or the borrower. This is likely to result in numerous instances of duplicate escrows, unnecessarily burdening and confusing borrowers. Lenders and borrowers will also waste significant time and resources investigating, placing, and resolving instances in which escrow did not need to be established. Borrowers will see little value in a subordinate lender requiring an escrow account for flood insurance.

Requiring escrow for modifications, especially for second mortgage loans such as those through the Making Home Affordable Second Lien Modification Program, will be extremely difficult. These loan modification documents will not typically include escrow requirements and modification payment calculations will not have included escrow amounts. It is unclear if a lender would have the legal authority to add such a requirement after the fact. Borrowers in the process of loan modification will also be especially sensitive to payment shock, especially if these additional costs were not anticipated in any of their loan documentation or in discussions with the lender.

Approximately 5 percent of all 1-4 unit residential properties are located in the Special Flood Hazard Area (SFHA) and subject to the mandatory purchase requirement. The vast majority of first mortgage lenders have escrow capability and will require a flood insurance escrow account on loans made, increased, renewed, or extended after July 6, 2014. Consequently, the number of subordinate, designated loans where the senior lien holder will not establish an escrow account for flood insurance is likely to be a fraction of that 5 percent. Requiring lenders to build and maintain escrow capability for this small number of loans will require significant investment for lenders, a cost that will be passed to borrowers with very little benefit to the lender, the borrower, or the NFIP.

As an alternative to mandating flood insurance escrow accounts on subordinate lien loans, MBA supports the continuation of the current process to list junior lien holders on flood insurance policies as mortgagees. If the flood insurance policy is cancelled, the junior lien holder will receive notice and can step in and force-place coverage at that time. This is a much simpler process for all involved and one that accomplishes the same goal.

Because of the unique nature of home equity lines of credit (HELOC) and Reverse Mortgage Loans (Reverse Loans), MBA is especially concerned about the implementation of escrow requirements for HELOCs and Reverse Loans that are outstanding as of July 6, 2014. These loan products do not typically require escrow for taxes, hazard, or flood insurance, and because escrow was not anticipated, outstanding HELOC and Reverse Loan documents will rarely include any language discussing escrow or allowing for such payment changes. Payment changes may represent violations of Truth in Lending laws,[5] and would only be possible if the borrower gives their approval.[6]

Because of the complicated nature of this issue and the consequences that a Truth in Lending violation would pose to lenders, MBA requests the Agencies confer with the Consumer Financial Protection Bureau (CFPB) and either exempt outstanding HELOC and Reverse Loans entirely from the escrow requirement or clearly outline the process and any necessary safe harbors that should be afforded to lenders in order to fulfill these requirements. To ease implementation and in light of the many concerns raised above, lenders should not be required to escrow for either outstanding HELOC or Reverse Loans.

If the Agencies are not willing to include such an exemption, the industry would ask for additional clarity around a number of fundamental issues, such as what constitutes an "outstanding" HELOC or Reverse Loan. Would a lender be required to escrow for an outstanding HELOC with no outstanding balance, on which the borrower cannot take an advance, but which has not been discharged? In determining whether to escrow, should lenders consider the line of credit amount or the outstanding amount? For example, if a borrower takes out $100 on a $14,000 line of credit, does the requirement to escrow begin at that point and for what amount? If a borrower owes $14,000 but pays back $7,000 does the lender need to adjust the escrow amount? If the Agencies do not exempt these loans entirely, we recommend the Agencies require lenders to consider only the maximum line of credit or maximum loan amount. While borrowers may consider it absurd to require flood insurance for the full line of credit amount (especially if they have a zero balance), doing otherwise would greatly complicate the process, risking unintentional escrow errors as draws are made against the line.

Escrow requirements for outstanding HELOCs and Reverse Loans would also impose a significant cost and resource burden on lenders. Such loans are not typically housed on a system that has the capability to account for escrows. The burden and expense of adding such a capability or moving all HELOCs and Reverse Loans onto a system that

[5] 12 CFR § 1026.40(f).
[6] 12 CFR § 1026.40(f)(3)(iii).

has escrow capability is likely to be extreme, with the costs necessarily passed onto borrowers.

The MBA also requests that the escrow rule should expressly exclude loans on manufactured (mobile) homes with a chattel mortgage from the escrow requirement. Such homes are subject to the mandatory purchase requirement and are eligible for coverage under the NFIP. However, these loans are often serviced on consumer loan servicing systems without escrow capability. In addition, these loan documents do not typically require an escrow for hazard insurance or flood insurance and there are typically no real estate taxes collected on such collateral.

Because the collateral is "mobile," it may move into or out of a SFHA making it very difficult to compute an accurate estimated flood insurance premium for the next annual policy term to establish the flood escrow account. Insurance coverage on manufactured homes is already frequently provided on a "comprehensive" policy form that includes flood and hazard coverage on the structure, personal property, and additional living expenses, underwritten by private insurance providers who may not have escrow billing capability. Because these "comprehensive" policies provide coverage for additional living expense, most lenders consider them to be broader than the SFIP. Requiring escrow on such chattel mortgages could be difficult for the lender and the insurer and could force borrowers to purchase an NFIP policy that provides less coverage at increased cost. MBA thus recommends that the escrow rule exclude manufactured homes with a chattel mortgage from the mandatory escrow requirement.

The MBA also requests that the escrow rule expressly exclude non-performing 1-4 unit residential mortgage lines and loans that have been charged-off, are in bankruptcy, or are in foreclosure from the escrow requirement. These are non-performing loans on which the borrower is not making any regular payments. Because the lender has not removed the lien, either voluntary or force-placed flood insurance is required if these properties are located in the SFHA. No payments are anticipated from these borrowers unless the property is sold or the foreclosure process is completed. Since the lender is usually advancing its own funds for the flood insurance premium, requiring a flood insurance escrow account on a non-performing loan that is not making payments will accomplish nothing. Further, the special loan servicing systems that service many of these non-performing lines and loans anticipate no receipt of payments. Modifying those systems to create escrow capability is an unnecessary expense for lenders that will offer no value to borrowers or the NFIP.

The escrow rule should also expressly exclude temporary loans secured by 1-4 unit residential improved property with a term and maturity of less than two years. Such loans are often originated for bridge financing or a construction loan on a new home and may provide for irregular draws as construction progresses (similar to a HELOC).They may not require specific monthly payments on principal. Many of these projects move from start to finish in less than 12 months without an expectation of renewal or extension. Requiring a flood insurance escrow on these loans is therefore unnecessary, costly, and would provide little value to the borrower.

MBA supports the Proposal's position that a regulated lending institution need not establish an escrow account for flood insurance premiums and fees when the institution determines that flood insurance coverage is provided by a policy purchased by a common interest community rather than the borrower.

Timing

MBA appreciates the Proposal's recognition that establishing escrow accounts for outstanding loans may pose a burden to both lenders and borrowers. To address that burden, MBA strongly recommends that flood insurance escrow on a traditional, first-position 1-4 unit residential mortgage loan be required only after a MIRE event. In the event the Agencies require a flood escrow on existing traditional first-position 1-4 unit residential mortgage loans outstanding as of July 6, 2014, MBA is concerned that the proposed provisions may not reduce that burden and may unintentionally antagonize borrowers by necessitating escrow shortages from the first escrow payment date.

Under the Proposal, regulated lending institutions must 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. MBA is concerned that this timeline may be too narrow and may not effectively take into account the process by which escrow modules function. MBA requests that the proposed regulations be amended to instead specify that a lender will be deemed to have complied with these requirements if the lender sends the prescribed 90-day notice and initiates the required notice to the borrower that subsequent payments will be increased, even if the first escrow payment does not begin for up to ninety days following the renewal date.

This concern may be best illustrated using an example. If a policy were to renew on July 7, 2014, the lender is expected to begin escrowing in August. To generate the notice of escrow payment change 60 days prior to the payment change date (June 1st), the lender would need to activate escrow on the loan before June 1st. Once a borrower becomes an escrow borrower, the loan servicing system will recognize the existing flood policy immediately, and will disburse the annual premium next due (July 7, 2014) even though there are no escrow funds in the account. This would unnecessarily create an escrow shortage, and would likely cause a duplicate payment to the flood insurance provider, assuming the borrower pays the renewal premium as directed in the 90-day notice. MBA instead recommends that escrow begin in this case after payment of the July renewal by the borrower. This minor change would greatly increase borrower satisfaction and reduce the complications for lenders. The borrower would have adequate time to pay the annual renewal premium. The lender would have time to complete escrow analysis and communicate the monthly payment change amount to the borrower before the borrower begins making escrow payments to their account.

MBA also requests clarification from the Agencies that the Proposal's requirement that escrow premiums and fees be payable "with the same frequency as payment on the loan are made for the duration of the loan" applies solely to the timing of collection of escrow funds from the borrower and does not address the frequency or disbursement of

annual escrow premiums. Loan payment intervals may differ from escrow payment requirements. The Agencies should clearly state that such a process is permissible.

The Proposal also addresses the timing applicable to loans that were not designated loans at origination but which become designated loans after July 6, 2014. In the event the Agencies agree that loans only need to be escrowed for flood insurance after a MIRE event, MBA recommends that a loan that becomes a designated loan after July 6, 2014 should not require a flood insurance escrow, unless that loan already has an escrow for hazard insurance, taxes, or any other fees or charges as currently required under the National Flood Insurance Reform Act of 1994. In the event the Agencies must require a flood escrow on existing, traditional first-position 1-4 unit residential mortgage loans outstanding as of July 6, 2014, MBA supports the proposed process provided the timelines incorporate the same 90-day escrow window provision as detailed above. Again, without such a provision, it is likely that borrowers who find themselves newly required to pay flood insurance will also immediately face an escrow shortage. This is very likely to frustrate and confuse borrowers without a concurrent benefit.

Notice

In the event the Final Rule requires a flood escrow on existing traditional, first-position, 1-4 unit residential mortgage loans outstanding as of July 6, 2014, MBA requests clarity on notice procedures for policies that may renew near to the July 6, 2014 deadline, such as a policy that renews on July 7th. The proposed regulations would require a lender to provide notice to that borrower by April 8th, prior to the Act's implementation date. MBA requests the Agencies clarify that the notice timeframes begin on July 6th and that lenders may, but are not required, to send such notices prior to that date.

Exception

MBA supports the Proposal's inclusion of exceptions for certain regulated lending institutions that have total assets under a certain threshold. However, MBA reiterates its concern that junior lien holders will have great difficulty tracking whether or not a senior lien holder qualifies for an exception if subordinate lien loans and lines are not exempted from the flood insurance escrow requirement. This is especially true for situations in which a formerly exempt senior lien holder's assets grow to such an extent that they are no longer eligible for the exception. Unless the senior lien holder expressly notifies the junior lien holder, the junior lien holder would likely have no way of knowing that the senior lien holder is now required to hold escrow on the loan. A similar concern arises when an institution eligible for the exception sells senior loans to one that is not. Consequently, borrowers will often face periods of time in which escrow will be unnecessarily duplicated. MBA is unaware of any tracking process that would be able to effectively address this issue beforehand. Designing such a process will be extremely complicated and expensive and may ultimately prove to be impossible to do. MBA reiterates its recommendation that the Agencies exempt lenders in a junior position from costly – and likely impossible – ongoing monitoring requirements of senior lenders.

Change in ownership

The Proposal requires regulated lending institutions to begin escrowing premiums and fees for flood insurance with the first loan payment on or after the first renewal date of the borrower's flood insurance policy on or after the date that is six months from the transfer date of the loan. MBA asks the Agencies to confirm our understanding of these dates through the use of an example, as provided in other sections of the proposed rule. MBA's understanding of the prescribed dates is that if a loan is transferred on October 1, 2014, the transferee would need to calculate the first renewal date that is on or after April 1, 2015. The transferee would then be required to begin escrow upon the first loan payment after that date. Provided this understanding is correct, MBA argues that the situation warrants a deferral of the first escrow payment for up to 90 days, which would benefit all parties involved.

Additionally, MBA is concerned that the Agencies appear to be silent on the transfer of mortgage servicing rights (MSRs). MBA assumes that the Agencies' language focusing on ownership is the primary consideration, rather than the size of the servicer. For example, in situations where a transferor that owns the loan and qualifies for the exception transfers mortgage servicing rights to a transferee that does not qualify for the exception, the requirement to escrow would be based on the assets of the transferor-owner. MBA also assumes that if a large institution sells a loan to a small institution eligible for the exception, the small institution would also be able to waive escrow for the borrower. Because MSR transfers are common in the industry and the CFPB has highlighted both servicing transfers and the processing of escrow payments as points of emphasis,[7] the Agencies should clearly detail the processes and requirements expected in these scenarios. MBA would recommend that the determination of whether a loan is subject to escrow requirements be based on the exemption status of the originating lender at origination, and that the loan retain that status for the life of the loan. This would eliminate considerable confusion for borrowers in typical scenarios such when servicing rights are sold.

4. Force placement of flood insurance

Notice and purchase of coverage

The Agencies propose to amend their regulations to provide that the regulated lending institution or its servicer may charge the borrower for the costs of premiums and fees incurred for coverage beginning on the date on which flood insurance coverage lapsed or did not provide a sufficient coverage amount. The Agencies also interpret the Act to permit the force-placement of a flood insurance policy that is effective *the day after* expiration of a borrower's original insurance policy to ensure that it is continuous. MBA asks the Agencies to clarify that, in order to ensure continuous coverage, the policy should be effective *on the date* the borrower's original policy ceases. Because policies cease and begin at 12:01AM, making the policy effective on the same date will ensure continuous coverage.

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[7] CFPB Supervisory Highlights: Summer 2013, found at: http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf.

MBA also requests clarification that the industry would interpret the term "lapse" to mean whenever continuous coverage for the named insured under a flood insurance policy ceases to exist. Coverage can cease to exist for a number of reasons including normal expiration, non-renewal of a policy, or as the result of a mid-term cancellation due to underwriting or request by the insured. The regulations should clearly state that a lapse is any period in which flood insurance is not continuously maintained that protects the interest of the named insured.

It is important to note that coverage for the named insured (the borrower) under the NFIP standard flood insurance policy terminates at 12:01 AM on the expiration or cancellation date. There is a limited extension of coverage under the mortgage clause in the NFIP SFIP for the benefit of the mortgagee for a period of 30 days after the expiration or cancellation date. However, this extension provides no coverage for the named insured and an insurer who pays a claim to a mortgagee under this extension (but denies the claim for the named insured) is subrogated to the rights of the mortgagee granted under the mortgage on the property. The mortgagee extension provides no benefit to the named insured. Because the loan documents typically require the named insured to maintain continuous flood insurance coverage on the collateral, MBA agrees that the regulated institution or its servicer may charge the borrower for the costs of premiums and fees incurred for coverage beginning on the date on which flood insurance coverage was cancelled or expired for the named insured, because the force-placed policy protects the borrower from subrogation by the insurer.

Sufficiency of demonstration

The Proposal requires for the purpose of confirming a borrower's existing flood insurance coverage a regulated lending institution must accept from the borrower an insurance policy declarations page that includes the existing flood insurance policy number and the identity of and contact information for the insurance company or its agent, as confirmation of the existence of coverage. MBA is concerned that an affirmative requirement to always accept a declarations page may force the acceptance of policies that do not comply with the mandatory purchase requirement, without providing the lender with documentation to determine if the policy presented meets the mandatory purchase requirement. A requirement that lenders investigate the sufficiency of a policy's adequacy after the fact may require significant resources and take weeks or months to receive documentation that would allow a lender to make the necessary compliance determination. This would create the risk of extended periods of inadequate coverage with no reasonable means for the lender to effectively make that determination in a more timely manner. To help ensure the adequacy of the information a lender receives prior to acceptance, MBA recommends that the Agencies clarify that sufficient evidence of insurance coverage must also include the policy term effective dates, the current flood coverage amount, limitations and exclusions, the mortgagee and, if the coverage is provided on a private flood policy, some documentation that the policy either meets the Definition or meets the mandatory purchase requirement. In addition, financial requirements should be set to ensure that the private insurer has the financial capacity to pay claims.

MBA also requests the Agencies clarify that while a declarations page is one option that a lender must accept, there are circumstances in which a lender can, subject to safety and soundness, accept alternative evidence of insurance documents acceptable to the lender (i.e. a certificate of insurance) in order to cancel force-placed insurance. This is currently common practice for 1-4 family lenders, and would echo FEMA WYO Bulletin W-13013, which noted that "the NFIP recognizes certificates, or evidences of flood insurance, and similar forms," as evidence of insurance, provided certain information is included: the policy form/type, term, and number; insured's name and mailing address; property location; current and rated flood risk zone; grandfathering status; mortgagee name and address; coverage limits; deductibles; and annual premium.

5. Appendices A, B, & C

MBA thanks the Agencies for providing sample forms of notice to assist in the notification and education of borrowers. We note, however, that neither the Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance found in Appendix A, nor the Sample Form of Notice of Requirement to Escrow for Outstanding Loans found in Appendix B reflect the numerous scenarios anticipated by this rulemaking in which the lender may not be required to escrow. For example, the sample form of notice in Appendix B does not appear to anticipate situations in which a common interest community purchases the required policy or escrow scenarios for junior and senior liens. MBA requests the Agencies include a provision informing the borrower of these various scenarios and encouraging them to forward any and all pertinent information explaining why the lender should not begin escrowing. To prevent borrower confusion, the noted regulatory clarifications should be clearly laid out, which will in turn reduce the chance of duplicate escrowing.

In addition, the sample form of notice in Appendix A utilizes the same language regarding premiums and fees being made with the same frequency as loan payments that we noted a concern with earlier (see 3. Escrow Requirement). We request clarification both in the regulation and the form as to the impact of this language on disbursement of escrow funds.

COMMERCIAL/MULTIFAMILY RULE-SPECIFIC COMMENTS

Where applicable[8] and unless otherwise stated in this section, MBA's Commercial/Multifamily positions on the Proposal are in general agreement with the positions stated in the Single-Family (1-4 Units) Rule-Specific Comments.

- **NFIP and Private Flood Insurance Policy Language** - We examine the practical challenges with how a bank would make the determination if a private flood insurance policy would be "at least as broad" as a NFIP policy. MBA urges for the Proposal to be modified to allow banks to have the flexibility set financial requirements for an insurance company providing private flood insurance that is in conformity with the bank's safety and soundness standards.

[8] Certain sections of the Proposal, escrows for example, are only applicable to 1-4 unit residential structures.

- **Safe Harbor** - After examining the problems with the safe harbor provision that makes it unworkable, we provide an alternative safe harbor approach that calls for insurers to certify that their private insurance policies are "at least as broad" as the NFIP policies.

- **Escrow Exclusion for Multifamily Mortgages** – MBA strongly supports the Proposal's exclusion of over 4 unit multifamily mortgages from the escrow requirement.

- **Refunds for Force-Placed Flood Insurance** - The Agencies should withdraw this requirement as to existing loans and allow a substantial period for compliance prospectively and clarify that the lender's refund obligation is subject to the insurer's refund of the premium.

- **Sufficiency of Demonstration -** To help ensure the adequacy of the information a lender receives prior to acceptance, MBA recommends that the Agencies clarify that sufficient evidence of insurance coverage must include items specified in FEMA Bulletin W – 13013.

1. Differences between NFIP flood insurance and private flood insurance

Addressed below are differences between NFIP flood insurance and private flood insurance that complicate direct policy comparisons:

- ***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 multifamily and commercial property policies have substantially higher deductibles than are permitted for NFIP coverage. Moreover, most private property insurance policies now contain Named Storm Deductible Endorsements that raise the deductible amount from a flat sum to a percentage deductible (sometimes as high as ten percent) that is assessed separately on each building or structure.[9] Named Storm Deductibles apply to hurricanes and similar flood-generating events and are inconsistent with the purpose and structure of NFIP deductibles. In addition, private flood policies are often provided as blanket policies (covering multiple properties and structures). These blanket policies may include higher deductibles and terms that vary from the terms provided in NFIP policies.

- ***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. The NFIP policy does not contain an ACC.

[9] *See* http://www.naic.org/cipr_topics/topic_named_store_deductibles.htm.

- ***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."[10] 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 generally is a substantial delay between the binding of coverage and actual delivery of a policy. 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 or require the borrower to obtain an NFIP policy.

- ***Lack of manageable guidance to determine compliance*** – Without standard insurance language and/or policy forms, determining whether a proffered private policy meets the statutory criteria will require banks to conduct dozens or hundreds of case-by-case evaluations of issues requiring subjective decisions and are often disputed among parties, at times leading to litigation. This flood insurance policy analysis is outside the scope of evaluation that banks currently perform. Most banks do not possess the expertise to conduct this analysis

Given these concerns, it is highly problematic 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 be able to accept "private flood insurance".

In addition, MBA urges for the Proposal to be modified to allow banks to have the flexibility to set financial requirements for an insurance company providing private flood insurance that is in conformity with the bank's safety and soundness standards.

2. The Proposal's safe harbor provisions are unworkable

The idea of a safe harbor appears to rest on the assumption that private policies providing flood coverage closely resemble NFIP policies in terms and structure. As

[10] NFIP Flood Insurance Manual, "General Rules," at 15.

already noted, this is not the case. Each policy must be examined separately. A policy whose main insuring agreement is compliant may be rendered non-compliant when a Named Storm Deductible Endorsement is added. Similarly, policies providing "specific insurance" in which coverage and limits are limited on a location-by-location basis may not be compliant. There thus appear to be insurmountable problems associated with determining whether any particular policy qualifies for "safe harbor" status without a specific determination, which is subject to (1) having a policy to review (see discussion above), and (2) delay and expense while the review is conducted.

Although a laudable concept, the safe harbor approach discussed in the Proposal does not appear to be workable as a practical option for lenders. As a result, lenders and servicers are unlikely to be able to accept private flood insurance.

As an alternative, MBA strongly urges the Agencies to consider an additional safe harbor if an insurer certifies that its policy meets the criteria set forth in the Definition. As envisioned by MBA, a lender would be able to accept an insurer's endorsement on a policy or confirmation via a cover letter confirming that the policy is compliant with the mandatory purchase requirement of the Flood Disaster Protection Act (FDPA). This would put the burden for certification on the insurance industry, the group most qualified to perform the coverage review and investigation necessary to certify policies.

3. Exclusion of multifamily mortgages greater than four units from escrow requirements

MBA supports the Agencies' recognition that the escrow requirements were only meant to apply to 1-4 unit residential loans and that commercial loans (including residential properties with 5 or more units) should be excluded. MBA appreciates the Agencies recognition of the NFIP technical corrections legislation[11] that limited the applicability of the escrow requirement to: residential properties that clearly exclude multifamily loans with more than four units.

4. Force-placed premium refunds

The Proposal requires lenders to refund premiums for force-placed coverage in place during periods of duplicated coverage after a borrower provides satisfactory evidence that a compliant policy is in place. This proposal presents a number of serious issues.

In the typical force-place situation, a borrower, after notice and sometimes multiple notices, has failed to provide the lender with proof that flood insurance is continuously in place on the secured property. This failure is a breach of loan documents requiring the borrower maintain continuous coverage.[12] If the loan documents allow it to do so, when a lender force-places insurance coverage and charges the borrower, the lender has effectively lent money (the premiums paid) to the borrower. Until the borrower does so, the lender bears the risks that these sums will not be repaid as well as the costs

[11] Public Law 112-281, 126 Stat. 2485 (January 14, 2013).
[12] *See, e.g., Cohen v. American Sec. Ins. Co., supra*, 2013 WL 5890642, slip op. at *2 (7th Cir., November 4, 2013)(giving example of typical insurance requirements in a residential loan).

associated with placing coverage. Additionally, a regulated lender that does not timely force-place or accepts inadequate documentation of replacement coverage faces regulatory scrutiny and the imposition of civil money penalties.

When the lender force-places coverage, the force place insurer assumes the risks it has agreed to insure and is, as a matter of contract and state insurance law, entitled to charge a premium for the period of time it is on the risk. In cases involving force-placement under the FEMA Mortgage Portfolio Protection Program (MPPP), the current (October 2013) FEMA NFIP Manual allows only a pro rata cancellation of a pro rata policy prospectively from the date it receives notice of cancellation rather than from the date duplication began. The difference in premium refund, which may be substantial, could be borne by the lender under the proposed rules.

The structure of the rules creates the following issues: (1) the Proposal conflicts with existing loan documents requiring the borrower to bear the costs of force-placement; and (2) the requirement that a lender refund premiums, charges and interest from the date of duplication rather than from the date of cancellation shifts the costs of a borrower's breach of loan conditions to the lender. As the Seventh Circuit properly noted in *Cohen, supra*, the purpose of notices such as those in loan documents and the regulations themselves is to provide fair warning to borrowers of their obligation to provide insurance.

The Agencies should withdraw this requirement as to existing loans, allow a substantial period for compliance prospectively, and clarify that the lender's refund obligation is subject to the insurer's refund of the premium.

5. Sufficiency of demonstration

The Proposal requires for the purpose of confirming a borrower's existing flood insurance coverage a regulated lending institution must accept from the borrower an insurance policy declarations page that includes the existing flood insurance policy number and the identity of and contact information for the insurance company or its agent, as confirmation of the existence of coverage and requires that lenders investigate the sufficiency of a policy's adequacy. To help ensure the adequacy of the information a lender receives prior to acceptance, MBA recommends that the Agencies clarify that sufficient evidence of insurance coverage must include: the policy form/type, term, and number; insured's name and mailing address; property location; current and rated flood risk zone; grandfathering status; mortgagee name and address; coverage limits; deductibles; and annual premium, (see FEMA Bulletin W – 13013, March 13, 2013) the policy term effective dates, and, if the coverage is provided on a private flood policy, a certification (see above) that the policy either meets the Definition or meets the mandatory purchase requirement.

* * *

MBA appreciates the Agencies' hard work to develop this rule, and your careful consideration of the industry's comments. We look forward to working with you as you move forward. Should you have questions or wish to discuss any aspect of these comments further, please contact John Snook (202) 557-2861, JSnook@mba.org, Sara Singhas (202) 557-2826, SSinghas@mba.org, or George Green (202) 557-2840, GGreen@mba.org.

Sincerely,

Pete Mills
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Residential Policy and Member Services