IOWA BANKERS ASSOCIATION

8800 NW 62nd Avenue
PO Box 6200
Johnston, Iowa 50131-6200
515-286-4300 • 800-532-1423
515-280-4140 FAX
www.iowabankers.com

December 17, 2014

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW., Suite 3E–218
Mail Stop 9W–11
Washington, DC 20219
Via Electronic Delivery to:
regs.comments@occ.treas.gov
Re: Docket ID OCC–2014–0016

Robert deV. Frierson, Secretary
Board of Governors - Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551
Via Electronic Delivery to:
regs.comments@federalreserve.gov

Re: Docket No. R–1498

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429
Via Electronic Delivery to:
comments@fdic.gov
Re: RIN 3064–AE27

Re: Loans in Areas Having Special Flood Hazards

The Iowa Bankers Association (IBA) is a trade association representing approximately 345 banks and savings and loan associations operating in the state of Iowa. The IBA submits this letter on behalf of its members to the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC), (collectively, "the Agencies") in response to the proposal to amend their rules regarding loans in areas having special flood hazards to implement certain provisions of the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA), which amends some of the changes to the Flood Disaster Protection Act of 1973 mandated by the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters), as published in the October 30 Federal Register (79 FR 64518-64538).

First, please accept our gratitude and appreciation for issuing additional guidance on these matters. As you will note from our questions/comments, additional clarification is needed in order to promote consistency in complying with the revised flood rules.

## I. Exemptions

Section 13 of HFIAA, which amends section 102(c) of the FDPA includes a new exemption to the mandatory flood insurance purchase requirement providing flood insurance is not required, in the case of any "residential property," for any structure that is a part of such property but is detached from the primary residential structure and does not serve as a residence.
You have requested comments on whether this section should be clarified.

We believe additional clarification is needed regarding what constitutes "residential property". As you are aware, Iowa is predominately an agricultural state. Many Iowa borrowers own rural parcels of land which contain residential structures, as well as various non-residential detached structures. At times the detached structures add little value to the property but often the structures have a greater insurable value than the dwelling. In addition, some of the detached structures are income-producing (such as a hog confinement building) while others are used for storage (such as grain bins or structures housing agricultural equipment) and some even sit empty and are not used by property owners at all.

This challenge is not limited to agricultural properties. Many small business owners operate their businesses out of detached structures located on the same parcel as their dwelling; such as auto body repair shop located on the same parcel as the owner's residential dwelling. If an income-producing structure is located on the parcel, is the property still considered "residential property"? If so, how would you define "income-producing" for this purpose?

Also, does the term "residential property" include multi-family structures? What about mixed use structures – such as homes that double as a bed and breakfast and the owner's residence or a horse stable with the borrower's living quarters in it? Would a property with a mixed-use structure or multi-family structure be considered a "residential property" and eligible for the detached structure exemption?

The Agencies also ask if the term "residential property" should take into consideration not only the type of property securing the loan but also the loan purpose. We are not convinced basing the definition on loan purpose alone would solve the confusion. A property is often used as collateral for multiple extensions of credit for multiple purposes. For example, a lender may finance the initial purchase of a borrower's personal residence which contains detached structures and waive the flood insurance requirement for the detached structure. If the definition took into consideration loan purpose and expressly excluded business-purpose extensions of credit from the definition of "residential property," an additional extension of credit for a business-purpose secured by the same property, would be not be eligible for the detached structure exemption. Thus, the lender may have to require insurance on that same structure purely due to the loan purpose, not the use of the structure.

Without additional clarification in the Agencies' rule as to what constitutes a "residential property," it will be left to lender, examiner and possibly a court's interpretation. Such ambiguity in the rule will likely lead to lenders taking a more conservative approach and requiring flood insurance on all detached structures when possibly the exemption could have benefitted the borrower. Thus, the financial relief intended by Congress when it passed this provision would not be realized by property owners.

## II. Escrow Requirements

Section 25 of HFIAA amends section 102(d) of the Flood Disaster Protection Act (FDPA) to require a regulated lending institution, or a servicer acting on behalf of a regulated lending institution, escrow for all premiums and fees for flood insurance required for loans secured by residential improved real estate or a mobile home unless the loan or the lending institution qualifies for one of the statutory exceptions.

Section 25 of HFIAA provides an exemption from the escrow requirement for "nonperforming loans" and the Agencies propose to define a "nonperforming loan" as a loan that is 90 days or more past due. The preamble to the proposed rules states *"the Agencies believe the proposed clarification is consistent with many lenders' current practices and will ensure that all regulated lending institutions use the same standard in determining when a loan is nonperforming for purposes of this provision."* We ask that the Agencies consider further clarification on how to determine if the loan is 90 days past due.

Recent rule-making by the Consumer Financial Protection Bureau (CFPB) which prohibits a lender from initiating a foreclosure proceeding until the borrower is past due 120 days or more has made it evident that lenders in fact, do NOT use the same standards for calculating past due timeframes. Thus, the CFPB has proposed to amend its rule to explain how to calculate past due timeframes. However, even recent rule-making provides differing explanations for calculating the number of days a payment is past due. For example, the recent final rule issued by the CFPB amending section 1026.43 (as issued in the November 3, 2014 Federal Register) provides an explanation of how to calculate the number of days past due in the Official Staff Commentary to section 1026.43(e)(3)(iii):

2. … *For this purpose, ''past due'' means the failure to make a periodic payment (in one full payment or in two or more partial payments) sufficient to cover principal, interest, and, if applicable, escrow under the terms of the legal obligation. Other amounts, such as any late fees, are not considered for this purpose. For purposes of § 1026.43(e)(3)(iii)(B)(3), a periodic payment is 30 days past due when it is not paid on or before the due date of the following scheduled periodic payment and is 60 days past due when, after already becoming 30 days past due, it is not paid on or before the due date of the next scheduled periodic payment.*

*i. Assume a loan is consummated on October 15, 2015, that the consumer's periodic payment is due on the 1st of each month, and that the consumer timely made the first periodic payment due on December 1, 2015. For purposes of § 1026.43(e)(3)(iii)(B)(3), the consumer is 30 days past due if the consumer fails to make a payment (sufficient to cover the scheduled January 1, 2016 periodic payment of principal, interest, and, if applicable, escrow) on or before February 1, 2016. For purposes of § 1026.43(e)(3)(iii)(B)(3), the consumer is 60 days past due if the consumer then also fails to make a payment (sufficient to cover the scheduled January 1, 2016 periodic payment of principal, interest, and, if applicable, escrow) on or before March 1, 2016. For* *purposes of § 1026.43(e)(3)(iii)(B)(3), the consumer is not 60 days past due if the consumer makes a payment (sufficient to cover the scheduled January 1, 2016 periodic payment of principal, interest, and, if applicable, escrow) on or before March 1, 2016.*

Whereas, the CFPB proposed revisions to the Regulation Z's servicing rules found in section 1026.41 provides the following explanation of how to calculate the "delinquency period:"

*.41(d)(8) Delinquency information.*

*1. Length of delinquency. For purposes of § 1026.41(d)(8), a consumer's delinquency begins on the date an amount sufficient to cover a periodic payment of principal, interest, and escrow (if applicable) became due and unpaid, even if the consumer is afforded a period after the due date to pay before the servicer assesses a late fee. A consumer is delinquent if one or more periodic payments of principal, interest, and escrow (if applicable) are due and unpaid.*

*2. Application of funds. For purposes of § 1026.41(d)(8), if a servicer applies payments to the oldest outstanding periodic payment, a payment by a delinquent consumer advances the date the consumer's delinquency began. For example, assume a mortgage loan obligation under which a consumer's periodic payment sufficient to cover principal, interest, and escrow is due on the first of each month. A consumer fails to make a payment on January 1, but makes a periodic payment on February 1. The servicer applies the payment received on February 1 to the outstanding January payment. On February 2, the consumer is one day delinquent, and the following periodic statement should disclose the length of the consumer's delinquency using February 2 as the first day of delinquency.*

Our interpretation is the two explanations provided by the CFPB in two separate provisions in Regulation Z will result in the same result for calculating the number of days past due/delinquent. We encourage the Agencies to add further clarification to this rule in how to determine the number of days an obligation is past due and to adopt the language provided by the CFPB in one of the rulemakings above to provide consistency across regulatory requirements and promote compliance.

The proposal also contains an exemption from the escrow requirement for loans with a term of 12 months or less. Would renewals or extensions of these short term loans also be exempt from the escrow requirement, provided the renewal or extension was also for a term of 12 months or less? Please add clarification in the final rule regarding renewals or extensions of credit with a term of 12 months or less.

Finally, the rule provides an exemption for small lenders who are under a prescribed asset size and who, <u>on or before July 6, 2012</u>, did not have a policy of consistently and uniformly requiring the deposit of taxes, insurance premiums, fees, or any other charges in an escrow account for loans secured by residential improved real estate or a mobile home. The preamble states *"The Agencies read the statutory condition to provide that if a regulated lending institution had a policy of consistently and uniformly requiring the deposit of taxes, insurance premiums, fees, or* *any other charges in an escrow account for even a portion of its portfolio of residential loans, such a lender would not be eligible for the exception, consistent with the statutory language."*

Does this mean that if the lender started escrowing after July 6, 2012 for loans other than HPMLs, and was under the asset-size threshold, it could still qualify for the small lender exemption if it currently does escrow for a small portion of its residential loans that were originated after July 6, 2012? If the escrow accounts were all opened after July 6, 2012, is the lender eligible for the exception? What if the accounts were opened after July 6, 2012 but the lender takes the step to close these escrow accounts prior to the mandatory compliance date of this final rule?

Several of our members have reported they do maintain a small number of non-HPML residential borrower escrow accounts; typically upon the borrower's request not because the bank "requires" the escrow account. If the accounts are maintained upon the borrower's request, rather than due to the lender's requirement, is the lender eligible for the exception? If so, how does a lender evidence the escrow account is not "required." Further explanation is needed on this matter.

## III. Notice Requirement

The Agencies have proposed changes to Appendix A's sample Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance to add information regarding the escrow requirement for residential properties. We have no objections or suggestions for improvements to the added language.

We do however, request the Agencies also consider adding language regarding the ability of the lender to waive flood insurance requirements on detached non-residential structures located on residential properties. Part 13(b) of the HFIAA provided that the RESPA booklet be updated to include the following notice in the RESPA Settlement Information Booklet (SIB): *"Although you may not be required to maintain flood insurance on all structures, you may still wish to do so, and your mortgage lender may still require you to do so to protect the collateral securing the mortgage. If you choose to not maintain flood insurance on a structure, and it floods, you are responsible for all flood losses relating to that structure."* We suggest this language also be added to the Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance to ensure more consumers are fully informed of such risks.

The RESPA SIB is only required for applicants applying for purchase money transactions. Thus, applicants applying for a refinance or subordinate lien loan secured by residential properties will not receive this important notice. While a lender may waive the flood insurance requirement on detached structures on a residential property, some property owners may be interested in purchasing flood insurance if they are aware it is available. Lenders have also expressed concerns regarding civil liability that may occur if flood insurance coverage is waived on detached structures and notice is not given that flood insurance was available. Providing the notice for all transactions in which flood insurance could be waived would reduce the risk of a consumer (for whom the bank waived flood insurance on a detached structure) bringing legal action against the lender if their property flooded and a loss was incurred on the detached structure - alleging they weren't informed that flood insurance was available on the detached structure and they had the option to insure it even though the lender didn't require such coverage. Incorporating the language into the Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance will provide this important information to all property owners located in a special flood hazard area without causing additional compliance burden on lenders.

**IV. Small Lender Exception to Escrow Requirement**

The Agencies propose to maintain the small lender exception provided in the HFIAA in their final rule. In order to be deemed a "small lender," the institution must:

- Have total assets of less than $1 billion as of December 31 of either of the two prior calendar years; and
- On or before July 6, 2012:
    - Was not required under Federal or State law to deposit taxes, insurance premiums, fees, or any other charges in an escrow account for the entire term of any loan secured by residential improved real estate or a mobile home; <u>and</u>
    - Did not have a policy of <u>consistently and uniformly requiring</u> the deposit of taxes, insurance premiums, fees, or any other charges in an escrow account for any loans secured by residential improved real estate or a mobile home.

Many small lenders do not have the systems and staff to maintain escrow accounts but do establish escrow accounts at closing for loans that will be sold to secondary market investors. These escrow accounts are established based on the policy/requirement of the investor, not the institution's policy. If the loan were to be held within the institution's loan portfolio, an escrow account would not be established. We ask the Agencies provide additional language to its definition of a small lender to clarify a lender that establishes escrow accounts at loan closing only per the requirement of secondary market investors as a condition for forward sale, does not have a "policy of consistently and uniformly requiring" escrow accounts if those are the only loans for which it requires escrow accounts.

**V. Institutions with a Change in Status**

As proposed, institutions that were exempt as a small lender and have a change in status must begin escrowing by July 1st of the calendar year succeeding the calendar year the change in status occurred for new loans **and** must notify all existing residential mortgage loan borrowers by September 30 of the option to escrow for flood insurance premiums. We request the Agencies extend the timeframes for both provisions until January 1 of the year following the year the institution had a change in status ~ giving the bank a full year to begin escrowing.

Smaller institutions that are exempt from the escrow requirements and have elected not to offer escrow accounts have made this decision for a reason. They typically do not have the resources or staff to "flip a switch" and begin escrowing in a short timeframe. Even more burdensome to them than the initial cost of implementing an escrow system is staffing the production and maintenance of systems. These small banks are often short-staffed and finding qualified staff takes time. Often new staff has little or no background in compliance or mortgage lending regulations and thus, needs extensive training before they can begin the task of determining if existing systems can support escrow account creation and maintenance or if a new system needs to be secured, coordinating efforts with the institution's loan operations systems, identifying impacted borrowers, doing the initial analysis, etc. If an institution does not have staff in place, it's unlikely all this can be accomplished in six short months. Therefore, we ask institutions be given a full year to begin escrowing for both new mortgage loan customers and offering escrow services to existing residential mortgage loan customers for whom flood insurance is required when a change in status occurs and the institution loses is small lender exemption.

## CONCLUSION

The Iowa Bankers Association and our member banks thank you for the opportunity to provide comments on the proposed amendments to the Agencies' rules to implement HFIAA provisions amending the FDPA. If you have questions about these comments, please contact the undersigned at 515-286-4361 or via e-mail at rschlatter@iowabankers.com.

Sincerely yours,

Ronette Schlatter, CRCM
Senior Compliance Coordinator