December 29, 2014

Re: Loans in Areas Having Special Flood Hazards; RIN 1557-AD84; RIN 71-AE22; RIN 3064-AE27; RIN 3052-AC93; RIN 3133-AE40

Ladies and Gentlemen:

As a compliance officer at a Midwest community bank, I appreciate the opportunity to comment on the proposal referenced above.

The enactment of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) set in motion unprecedented change to the National Flood Insurance Program (NFIP) intended to restore the flood insurance program's financial solvency and sustainability.

Although many of the interpretive questions presented by Biggert-Waters were answered by HFIAA amendments, care must be exercised to write rules that will further effectuate Congress' dual objectives – establishing an affordable *and* sustainable federal flood insurance program.

We concur with the ABA's request to grant lenders broad discretion to apply section 13 of HFIAA to exclude from the mandatory purchase obligation low value, non-residential structures that are detached from a residential structure, regardless of the purpose of the loan secured by a residence.

We also concur with the ABA's request for additional clarifications and changes to the proposed rules on mandatory escrow to ensure that escrow requirements do not inadvertently increase the cost of credit – without advancing the Congressional goal of ensuring that borrowers maintain flood insurance over the life of their loan.

Regarding the requirement of flood insurance for residential detached structures:

The FDPA's requirement to insure *any* building – even a low value detached structure – that secures a designated loan adds considerably to borrowing costs while rarely providing value to borrowers. Because an NFIP policy insures only one building, a borrower must purchase a Dwelling Policy to insure the residence and a separate policy, a General Property Form, to insure any non-residential detached structure located in a flood zone on the property under the NFIP. Insurance premiums and deductibles for non-residential structures, however, are considerably higher than those for residential structures. Moreover, under a General Property Form loss is calculated on the depreciated value of the structure. This fact, coupled with the high deductibles applied to non-residential structures, often means that in the event of a flood loss a General Property Form policy may not pay out.

Predictably, borrowers frequently complain when required to insure these structures and we strongly support any amendment that would give lenders the discretion to exempt low-value non-residential structures from the mandatory purchase obligation.
We also urge the Agencies to inform their examiners that well-intentioned applications of the exemption – which pre-date the issuance of a final rule and may be inconsistent with any clarifications announced by the rule – should not be subject to supervisory criticism.

We disagree with the suggestion in the Proposal that "the term 'residential' may refer not only to the type of property securing the loan, but also to the purpose of the loan." Nothing in section 13 suggests that the exemption should be limited by anything other than the ***type*** of property securing the loan, a residential structure. The purpose of the loan proceeds is immaterial. A borrower who uses his or her home to secure a business, commercial or agricultural purpose loan faces the same affordability challenges when forced to insure a low-value detached structure as a borrower who uses the collateral to secure a residential mortgage or other consumer purpose loan. Moreover, bankers should not be placed in the difficult position of explaining to a borrower that a qualifying detached structure, which is not required to be insured as a condition of a residential mortgage transaction, must be insured if the bank takes a second lien on the same residential property to secure an extension for credit for business, commercial or agricultural purposes. From the borrower's perspective, the purpose of the loan is immaterial. Doing so may also produce the unintended consequence that borrowers will be discouraged from applying for Small Business Administration (SBA) loans as SBA program loans require a lender to take a security interest in the residence of the borrower.

Conversely, there are detached structures that have significant value for which it is in the interest of both the bank and borrower to insure the building. The statement, added to the Special Information Booklet, "[Y]our mortgage lender may require you to [purchase a flood insurance policy] to protect the collateral securing the mortgage" clearly expresses Congress' intent for the decision about whether to offer a borrower the opportunity to use the exemption to be at the discretion of the lender. Accordingly, each bank should be free to exercise this discretion and individually establish criteria to guide determinations about when to require flood insurance for a qualifying detached structure. In addition, we urge the Agencies to confirm either in the supplemental materials to the final rule or interagency exam procedures that examiners are to give deference to reasonable determinations regarding the application of the exemption that are made in accordance with a bank's collateral risk management policy.

Regarding the definition of residential property:

We encourage the Agencies to adopt a definition of residential property that focuses on the residential ***use*** of the structure – regardless of its nature or size – that is consistent with similar definitions in the FDPA and Regulation H. The term "residential property" should be broadly defined to encompass any residential structure, including single-family dwellings, two to four family dwellings, multi-family dwellings containing five or more residential units, and even mixed-use buildings as long as the primary purpose of the building is for residential purposes. Within the context of escrow, the FDPA defines the term "residential improved real estate" as "improved real estate for which the improvement is a residential building."

The plain language of section 13 is consistent with an inclusive definition; it states, "[F]lood insurance shall not be required, in the case of *any* residential property, for any structure that is part of such property but is detached from the primary residential structure of such property..."

Regarding the definition of "serves as a residence"

We as financial institutions struggle with the ambiguity related to when a detached structure that might qualify for the exemption "serves as a residence," thereby making it subject to the mandatory purchase obligation. We request the Agencies to describe generally (either in the supplemental materials or in guidance) the features or facilities that, if present, could mean that a structure "serves as a residence," but we urge the Agencies to avoid defining the term in a rule that could supplant lender discretion.

The Agencies should clarify that the test is whether the structure is *designed for use* as a residence (i.e., it has sleeping, bathroom and kitchen facilities), not how the structure is actually being used at any point in time.

In addition, we urge the Agencies to confirm that there is no duty under the FDPA for a lender to monitor residential collateral to determine if an exempt detached structure is later remodeled and then "serves as a residence." Our institution has have little, if any, post-closing communications with borrowers on loans secured by residential property and do not typically inspect the premises.. However, consistent with existing obligations under the FDPA, financial institutions recognize that if a lender becomes aware that a property should be reclassified, the lender would have a duty to inform the borrower of the obligation to insure the property and be prepared to enforce that obligation if the borrower fails to purchase a flood insurance policy.

Regarding the required use of the Standard Flood Hazard Determination Form

The proposed amendment would clarify that a regulated lending institution need not perform a flood hazard determination for any properties or structures that are exempt from the mandatory purchase obligation. The proposed clarification misunderstands the timing and process of flood hazard determinations, as, most lenders order a flood hazard determination upon receipt of a loan application; the order requests a flood hazard determination for the property address and includes all structures on the property. In fact, in many instances, it is the receipt of the flood hazard determination that alerts the lender to the existence of a detached structure on the property. A detached structure also may be identified by an appraisal or survey, but these documents are not received until well after the determination has been ordered. On the other hand, when a lender is aware upon receipt of a loan application that the property contains a detached, non-residential structure, the structure typically has value. In these cases, the lender specifically directs that the flood hazard determination determine whether the structure is located in a special flood hazard area so that it can require the purchase of flood insurance and can order life-of-loan monitoring.

Accordingly, we urge the Agencies to confirm that a bank *may* obtain and charge a borrower for a flood hazard determination on a property address that has a detached structure, as it may be determined at a later date that a portion thereof qualifies for the exclusion.

For future consideration:

After the Agencies finalize the rules required by Biggert-Waters and HFIAA, we request that the Agencies reconsider the topic of low value structures, specifically low value structures that are located on property securing a commercial, business, or agricultural loan that is *not* secured by a residence. In July of 2009, the Agencies proposed additional Interagency Questions and Answers on Flood Insurance (Interagency Q & As) to provide guidance to the industry on determining the appropriate amount of flood insurance under the FDPA and Regulation H, or the "insurable value" of a structure.[15] Recognizing the problems presented by the requirement to insure a structure that would not be rebuilt (at all, or in its current form) for its "replacement cost value," the Agencies proposed two alternative valuation methods, the "functional building cost value" and the "demolition removal cost value."

When the Agencies finalized the Interagency Q & As in 2011, it withdrew these alternative valuation methods, believing that its guidance on insurable value rendered the alternative valuation approached unnecessary. The banking industry respectfully disagrees, and strongly encourages the Agencies to reconsider the issues presented by low value structures as part of a much needed review and restatement of interagency guidance on insurable value.

Recommendations for Implementation of the Mandatory Escrow Provision

Section 25 of HFIAA makes a number of amendments to Biggert-Waters' mandatory escrow provision, including clarifying that mandatory escrow only applies to loans that are "originated, refinanced, increased, extended or renewed on or after January 1, 2016;" defining the term "outstanding loan" as a loan that is outstanding as of January 1, 2016; and exempting the following categories of loans from the mandatory escrow requirement:

- Commercial purpose loans secured by a residence
- Subordinate liens, if at the time of origination the first lien is properly insured
- Condominium, cooperative, and project development loans, under defined circumstances
- Home equity lines of credit
- Nonperforming loans, and
- Loans with a term of less than 12 months.

We concur with the ABA's request for additional clarifications to ensure that the statutory escrow provision achieves its intended customer benefit.

1. The proposed amendment of the general escrow requirement

As stated above, HFIAA §25 amended the mandatory escrow provision to clarify that mandatory escrow only applies to a designated loan "originated, refinanced, increased, extended or renewed on or after January 1, 2016.", In addition, we urge the Agencies to exercise their interpretive authority to tie implementation of the new requirement to *applications received* on or after January 1, 2016 that result in a designated loan being made, increased, extended, or renewed. In December of 2015 there will be applications in process that have been approved, priced, and documented as "non-escrow" loans. Under the proposed regulation, for those loans that are in the pipeline – but for one reason or another have not been closed before January 1, 2016 – the bank will have to ask the borrower to return to the bank so that the loan documentation and pricing can be changed to require the escrow of flood insurance premiums and fees. By clarifying that mandatory escrow is required for all applications received after the effective date of the statute; the Agencies can help consumers avoid this inconvenience and potential annoyance.

2. The exemption for a loan in a junior or subordinate position

HFIAA §25 exempts from mandatory escrow a loan "in a junior or subordinate position to a senior lien secured by the same residential improved real estate or mobile home for which flood insurance is being provided at the time of origination of the loan." The Agencies propose to implement this section with the following clarifications, "The loan is in a junior or subordinate position to a senior lien secured by the same residential improved real estate or mobile home for which **the borrower has obtained** flood insurance **coverage that meets the requirements of [the mandatory purchase obligation].**" We urge the Agencies to confirm that a lender does not have an obligation to monitor (and document) its lien position over the life of the loan to demonstrate that the loan qualifies for the exemption. Rather, a lender should be able to assume that the loan remains in a subordinate position, exempt from the obligation to escrow, unless the lender is notified that the first lien has been paid off or a statutory trigger occurs – a request by the borrower to increase, renew, or extend the loan. That request would result in a bank re-checking lien status, and if the bank discovered that the first lien had been paid off, the bank would initiate escrow, unless it qualifies for the small lender exemption.

3. The exemption for a nonperforming loan

We request that nonperforming in this context be defined as a loan that is 90 or more days past due. A loan's past due status, however, can and often does fluctuate as a financially distressed borrower makes, and misses, payments. Therefore, we ask the Agencies to confirm that once a designated loan is 90 days past due and qualifies for the exemption, it retains that status, even if the borrower makes additional payments. We urge the Agencies to confirm that receipt of payments on a non-performing loan (which may render the loan less than 90-days past due) will not result in a loss of the exemption.

4. The exemption for a loan with a term of less than one year

We encourage the Agencies to exercise their interpretive authority to clarify that the exemption applies to a "loan that has a term of not longer than 12 months which may be extended as necessary to complete the project, provided the extension does not exceed 12 months."
In addition, we urge the Agencies to exercise their interpretive authority to clarify that the exemption applies to construction-to-permanent loan financing, and the obligation to escrow begins when the permanent financing loan documents are executed and the loan is moved from a construction loan servicing system (which typically lacks escrow capabilities) to a mortgage loan servicing system (which will have escrow capabilities, unless the lender qualifies for the small lender exemption).

5. The proposed model notice

We are concerned that the language the Agencies have proposed suggests that escrow is mandatory for *all* loans secured by residential property located in a flood zone and does not reflect the exemptions that may apply. Thus, the proposed disclosure would not apply to an exempt loan and may generate unnecessary concern and confusion among consumers. The solution, however, is not to create two versions of the Notice of Special Flood Hazards, one that includes the proposed new disclosure and one that does not. Typically the Notice of Special

Flood Hazards is provided to the borrower with other disclosures within three days of receipt of a completed application. At that stage of the origination process, a lender may not have determined whether one of the exemptions applies. In the case of a loan secured by an individual condominium unit, for example, a lender is unlikely to have a copy of the declarations page from the Residential Condominium Building Association Policy to enable the lender to determine whether the loan is exempt from escrow and which version of the Notice to send the borrower. We suggest the following modifications to the proposed model language:

Escrow Requirement for Residential Loans
Federal law ***may*** require a lender or its servicer to escrow all premiums and fees for flood insurance that covers any residential building or mobile home securing a loan that is located in an area with special flood hazards. ***If an escrow is required for your loan, your lender will notify you. In that event,*** These the premiums and fees must be paid to the lender or its servicer with the same frequency as your loan payments for the duration of your loan ***as long as your residential building or mobile home remains in a special flood hazard area***, and will be deposited in an escrow account on your behalf to be paid to the flood insurance provider. Upon receipt of a notice from the flood insurance provider that the premiums are due, the premiums shall be paid from the escrow account to the insurance provider.

6. Optional escrow

We urge the Agencies to clarify that the status of the loan as of the effective date of the escrow requirement, or January 1, 2016, should be dispositive for purposes of determining whether a lender is required to send the notice. As discussed previously, if a customer's account is 90 or more days past due on January 1, 2016, it should be clear that the lender is not required to mail or deliver a notice informing the customer of the option to escrow, in the event the customer subsequently makes a payment which makes the account less than 90 days past due. Similarly, a bank should not have to monitor the lien status of existing loans after January 1, 2016 in order to provide those customers whose lien status changes with notice that they have the option to escrow. The burden and costs imposed by such a monitoring regime would outweigh significantly the incidence of consumer opting in to escrow.

7. The proposed timing of the notice informing customers of optional escrow

We support the proposed requirement for a lender to establish escrow "as soon as reasonably practicable" after the lender or servicer receives the borrower's request. Establishing a specific time frame that must be observed regardless of the individual circumstances would present unnecessary operational challenges. As the Agencies are aware, the banking industry has a strong record of compliance with similar standards for responding to consumer requests to revoke a decision to "opt-in" to overdraft protection under Regulation and to revoke consent to a card issuer's payment of "over-the-limit" transactions under Regulation Z. No greater specificity is necessary to assure establishment of an escrow account within a timeframe appropriate for the circumstances and legal constraints.

Respectfully submitted