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DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
[Docket ID OCC-2011-0024]

FEDERAL RESERVE SYSTEM
[Docket No. OP-1431]

FEDERAL DEPOSIT INSURANCE CORPORATION
[RIN 3064-ZA00]

FARM CREDIT ADMINISTRATION
[RIN 3052-AC46]

NATIONAL CREDIT UNION ADMINISTRATION
[RIN 3133-AD41]

Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Farm Credit Administration (FCA); National Credit Union Administration (NCUA).

ACTION: Notice and request for comment.

SUMMARY: The OCC, Board, FDIC, FCA, and NCUA (collectively, the Agencies) are finalizing two new questions and answers, one relating to insurable value and one relating to force placement, and withdrawing one question and answer regarding insurable value. The two final questions and answers supplement the "Interagency Questions and Answers Regarding Flood Insurance" (Interagency Questions and Answers), which were published on July 21, 2009 (74 FR 35914). Based on comments received, the Agencies also have significantly revised two questions and answers regarding force placement of flood insurance that were initially proposed on July 21, 2009, and are proposing revision to a previously finalized question and answer. These three revised questions and answers are being proposed for comment.

DATES: Effective date of final questions and answers: October 17, 2011. Comment due date: Comments on the proposed questions and answers must be submitted on or before December 1, 2011.

ADDRESSES: Although the Agencies will jointly review all the comments submitted, it will facilitate review of the comments if interested parties send comments to the agency that is the appropriate federal regulator for the type of institution addressed in the comments. Interested parties are invited to submit written comments to:

OCC: Because paper mail in the Washington, D.C. area and at the Agencies is subject to delay, commenters are encouraged to submit comments by e-mail, if possible. Please use the title "Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- E-mail: regs.comments@occ.treas.gov.
- Mail: Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.
- Fax: (202) 874-5274.
- Hand Delivery/Courier: 250 E Street, SW., Attn: Communications Division, Mail Stop 2-3, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC-2011-0024" in your comment. In general, the OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice by any of the following methods:

- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC's Communications Division, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling in advance (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.
- Docket: You may also view or request available background documents and project summaries using the methods described above.

Board: You may submit comments, identified by Docket No. OP-1431, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.
- Federal eRulemaking Portal: http://www.Regulations.gov. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- Fax: (202) 452-3819 or (202) 452-3102.
- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information.

Public comments may also be viewed electronically or in paper in Room MP–500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN number 3064-ZA00 by any of the following methods:

- Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow instructions for submitting comments on the Agency Web Site.
- E-mail: Comments@fdic.gov. Include the RIN number in the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance

Corporation, 550 17th Street, NW., Washington, DC 20429.

- Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.
- Instructions: All submissions received must include the agency name and RIN number.
- Public Inspection: All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose.html including any personal information provided. Paper copies of public comments may be ordered from the Public Information Center by telephone at 1-877-275-3342 or 703-562-2200.

FCA: There are several methods for you to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the Agency's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act (29 U.S.C. 794d), we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. FCA requests that comments to the proposed amendment include the reference RIN 3052-AC46. You may submit comments by any of the following methods:

- E-mail: Send us an email at reg-comm@fca.gov.
- Web Site: http://www.fca.gov. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: http://www.Regulations.gov. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or from our Web site at http://www.fca.gov. Once you are in the Web site, select "Public Commenters" then "Public Comments" and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted, but for technical reasons, we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

NCUA: You may submit comments by any of the following methods (Please send comments by one method only):

- Federal eRulemaking Portal: http://www.Regulations.gov. Follow the instructions for submitting comments.
- NCUA Web Site: http://www.ncua.gov/RegulationOpinionsLaws/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include "[Your name] Comments on Flood Insurance, Interagency Questions & Answers" in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

Public Inspection: All public comments are available on the agency's Web site at http://www.ncua.gov/RegulationOpinionsLaws/comments as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT:

OCC: Pamela Mount, National Bank Examiner, Compliance Policy, (202) 874-4428; or Margaret Hesse, Special Counsel, Community and Consumer Law Division, (202) 874-5750, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Nikita M. Pastor, Senior Attorney, Division of Consumer and Community Affairs, (202) 452-2412; Lanette J. Meister, Senior Supervisory Consumer Financial Services Analyst (202) 452-2705; or Brad Fleetwood, Senior Counsel, Legal Division, (202) 452-3721, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. For the deaf, hard of hearing, and speech impaired only, teletypewriter (TTY), (202) 263-4869.

FDIC: John Jackwood, Senior Policy Analyst, Supervisory Policy Branch, Division of Depositor and Consumer Protection, (202) 898-3991; or Mark Mellon, Counsel, Legal Division, (202) 898-3884, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429. For the hearing impaired only, telecommunications device for the deaf TDD: 800-925-4618.

FCA: Mark L. Johansen, Senior Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4498, TTY (703) 883-4434; or Mary Alice Donner, Senior Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4033, TTY (703) 883-4020.

NCUA: Justin M. Anderson, Staff Attorney, Office of General Counsel, (703) 518-6540; or Pamela Yu, Staff Attorney, Office of General Counsel, (703) 518-6593, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

SUPPLEMENTARY INFORMATION:

Background

The National Flood Insurance Reform Act of 1994 (the Reform Act) (Title V of the Riegle Community Development and Regulatory Improvement Act of 1994) comprehensively revised the two federal flood insurance statutes, the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973. The Reform Act required the OCC, Board, FDIC, the Office of Thrift Supervision ("OTS"), and NCUA to revise their flood insurance regulations and required the FCA to promulgate a flood insurance regulation for the first time. The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, "the Agencies") fulfilled these requirements by issuing a joint final rule in the summer of 1996. *See* 61 FR 45684 (August 29, 1996).[1]

In connection with the 1996 joint rulemaking process, the Agencies received a number of requests to clarify specific issues covering a wide spectrum of the proposed rule's provisions. The Agencies addressed many of these requests in the preamble to the joint final rule. The Agencies concluded, however, that given the number, level of detail, and diversity of the requests, guidance addressing the technical compliance issues would be helpful and appropriate. Consequently, the Agencies decided guidance would be appropriate to address these technical issues subsequent to the promulgation of the final rule (61 FR 45685). The Federal Financial Institutions Examination Council (FFIEC) fulfilled that objective through the initial release of the Interagency Questions and Answers in 1997 (1997 Interagency Questions and Answers). 62 FR 39523 (July 23, 1997).

After notice and comment, on July 21, 2009, the Agencies updated the interagency guidance

(2009 Interagency Questions and Answers). 74 FR 35914 (July 21, 2009). In this publication, the Agencies also proposed five new questions and answers for comment. See 74 FR 35931. The proposed questions and answers addressed issues related to insurable value and force placement of flood insurance.

The Agencies received 28 total comments on the proposed questions and answers. These comments are discussed below.

The Agencies are adopting two of the five questions and answers proposed in the 2009 Interagency Questions and Answers: one question and answer relating to insurable value (question and answer 9) and another question and answer relating to force placement of flood insurance (question and answer 61). The Agencies are also withdrawing one question and answer relating to insurable value and have reserved this question and answer for later use (question and answer 10). However, as discussed below, because the Agencies propose to significantly and substantively change the answers to two of the questions and answers relating to the force placement of flood insurance, the Agencies are proposing them for additional comment (questions and answers 60 and 62). In addition, the Agencies are proposing changes to a previously finalized question and answer (question and answer 57) that also relates to the force placement of flood insurance to be consistent with the proposed changes to these two questions and answers.

The two questions and answers being adopted as final today supplement the 2009 Interagency Questions and Answers and other guidance or interpretations issued by the Agencies and the Federal Emergency Management Agency (FEMA). The Agencies will publish the combined and complete Interagency Questions and Answers in their entirety once the questions and answers that are being proposed for comment are finalized.

For ease of reference, the following terms are used throughout this document: "Act" refers to the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as revised by the Reform Act (codified at 42 U.S.C. 4001 *et seq.*). "Regulation" refers to each agency's current final flood insurance rule.[2]

Final and Withdrawn Questions and Answers

Section II. Determining when certain loans are designated loans for which flood insurance is required under the Act and Regulation.

Insurable value. In general, the questions and answers in Section II explain that, in order to comply with the Regulation, the amount of insurance required is the lesser of the outstanding principal balance of the designated loan or the maximum amount of insurance available under the National Flood Insurance Program (NFIP). The maximum amount of insurance available under the NFIP is the lesser of the maximum limit of coverage available for the particular type of property under the Act or "the overall value of the property securing the designated loan minus the value of the land on which the property is located." Consistent with terminology used by FEMA in its guidance, the Agencies use the term "insurable value" to denote the regulatory phrase "overall value of the property minus the value of the land." See generally question and answer 8.

The Agencies proposed questions and answers 9 and 10 in an effort to assist lenders in calculating the "insurable value" of a property for purposes of determining the required amount of flood insurance under the NFIP. Proposed question and answer 9 referenced FEMA guidelines in providing that the full insurable value of a building is the same as 100 percent replacement cost value (RCV)[3] of the insured building. Proposed question and answer 9 sought to illustrate the flexibility lenders have in determining RCV of a building by providing that lenders (either by themselves or in consultation with the flood insurance provider or other professionals) could consider permissible methods, such as the RCV used in a hazard insurance policy (recognizing that replacement cost for flood insurance will include the foundation), an appraisal based on a cost-value (not market-value) approach before depreciation deductions, and/or a construction cost calculation.

Proposed question and answer 10 provided alternatives to determining the insurable value other than RCV for certain nonresidential buildings used for ranching, farming, and industrial purposes when the borrower either would replace the building with a structure more closely aligned with the function the building is presently providing or would not replace the building if damaged or destroyed by a flood. In such cases, the alternatives proposed by the Agencies would have allowed the lender to determine the insurable value by either the "functional building cost value" or by the demolition/removal cost value.

Comments and Final Question and Answer 9

Although the Agencies received several comments commending the proposed guidance, numerous commenters objected to tying insurable value to RCV in all cases. Commenters stated that it was not possible to obtain RCV in many instances, particularly in cases of nonresidential properties. Commenters also stated that reliance on RCV was inappropriate for nonresidential properties because borrowers would only recover actual cash value[4] in the event of a loss for these types of properties, resulting in the borrower being over-insured.

In response, the Agencies reaffirm that the insurable value for certain residential or condominium properties should be written to RCV. Further, the Agencies recognize that this strict interpretation of insurable value as RCV may not be practical in all cases for nonresidential buildings. Although FEMA's guidance states that insurable value is the same as RCV, it also provides that lenders should avoid creating a situation in which the insured pays for coverage that exceeds the amount the NFIP will pay in the event of a loss.[5] In cases involving certain residential or condominium properties,[6] insurance policies should be written to, and the insurance loss payout would be the equivalent of, RCV. However, in cases involving nonresidential properties, as well as some residential properties, where the insurance loss payout is normally based on actual cash value, insurance policies written at RCV may require an insured to pay for coverage that significantly exceeds the amount the NFIP would pay in the event of a loss. Similarly, in the case of certain nonresidential buildings used for ranching, farming, or industrial purposes that the borrower either would not replace if damaged or destroyed by a flood or would replace with a structure more closely aligned to the function the building is providing at the time of the flood, payouts may be well below RCV. Further, in cases where the physical depreciation of a nonresidential building is very high, the actual cash value payout would likely be very low, causing an even larger gap in the amount of insurance purchased and the potential payout. As a result, requiring flood insurance equal to RCV in such instances may lead to over-insurance for such properties. Lenders, however, need to be equally mindful of avoiding situations in which, as a result of insuring at a level below RCV, they under-insure property. In determining the amount of insurance to require, lenders should consider the extent of recovery allowed under the applicable NFIP policy.

Given these practical considerations, the Agencies are adopting question and answer 9 with a revision to provide that, in calculating the required amount of insurance, the lender and borrower (either by themselves or in consultation with the flood insurance provider or other appropriate professional) may choose from a variety of approaches or methods to establish a reasonable valuation. They may use an appraisal based on a cost-value (not market-value) approach, a construction-cost calculation, the insurable value used in a hazard insurance policy (recognizing that the insurable value for flood insurance purposes may differ from the coverage provided by the hazard insurance and that adjustments may be necessary;

for example, most hazard policies do not cover foundations), or any other reasonable approach, so long as it can be supported. It is important for lenders to recognize that, when calculating the minimum amount of insurance that is required to be purchased, the insurable value is only relevant to the extent that it is lower than either the outstanding principal balance of the loan or the maximum amount of insurance available under the NFIP.

Withdrawn Question and Answer 10

In light of the alternative approaches suggested in final question and answer 9, the Agencies believe the specific exceptions to insurable value in proposed question and answer 10 are no longer necessary. As a result, the Agencies are withdrawing question and answer 10 and that number is reserved for future use.

Section X. Force placement of flood insurance

Section X addressed issues concerning the force placement of flood insurance. The section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers. The Agencies proposed changes to those existing questions and answers in March 2008 designed to provide greater clarity with no intended change in substance and meaning. These revisions were adopted in July 2009. In response to comments received, however, the Agencies proposed three new questions and answers (60, 61, and 62). These proposed questions and answers addressed the following force placement issues: when the 45-day notice period should begin, whether a borrower may be charged for the cost of flood insurance coverage during the 45-day notice period, and how soon after the end of the notice period a lender should purchase a flood insurance policy when the borrower has failed to purchase an appropriate policy.

The Agencies are adopting question and answer 61 as final, with minor nonsubstantive clarifications. However, after consideration of the comments received on questions and answers 60 and 62, the Agencies are revising these proposed questions and answers for further comment. The Agencies are also proposing revisions to question and answer 57 to make it consistent with proposed questions and answers 60 and 62.

Comments and Final Question and Answer 61

The Agencies proposed new question and answer 61 to address questions and concerns about how soon lenders have to force place insurance after the end of the 45-day notice period. The Regulation provides that the lender or its servicer shall purchase insurance on the borrower’s behalf if the borrower fails to obtain flood insurance within 45 days after notification. Proposed question and answer 61 stated that, given that the lender is already aware during the 45-day notice period that it may be required to force place insurance if there is no response from the borrower, any delay in force placing flood insurance should be brief. Where there is a brief delay in force placing required insurance, the proposed question and answer stated that the Agencies will expect the lender to provide a reasonable explanation for the delay.

The Agencies received comments from six commenters addressing proposed question and answer 61. Two lender commenters explained that batch processing of force placed flood insurance policies may cause a brief delay in the completion of the force placement process. They requested that the Agencies specify in the answer that, if a policy is in effect, for example, five days after the end of the 45-day notice period, then the force placement time frame has been satisfied. The Agencies decline to set an arbitrary number of days after the end of the 45-day notice period as a “safe harbor” for completion of the force placement process. The Agencies believe that the lender should have policies and procedures in place to allow force placement generally to commence when the 45-day notice period has expired. However, the Agencies also recognize that the process of force placing flood insurance may not always occur immediately on the 46th day. If there is a brief delay in force placing the required insurance, the lender should be able to provide a reasonable explanation for the delay.

A government-sponsored enterprise (GSE) commenter did not agree with allowing a brief delay, even if the lender could provide a reasonable explanation, noting that flood insurance coverage is required at all times during the term of the mortgage. This commenter also expressed concern over the concept of the 45-day notice period, which results in the unintended consequence that properties may be uninsured or under-insured during the term of the loan. The Agencies are unable to address this overall concern, given that the 45-day notice requirement is found in the Act.

The Agencies are adopting final question and answer 61 with minor nonsubstantive clarifications.

Revised Proposed Questions and Answers

Section X. Force placement of flood insurance

Section X addressed issues concerning the force placement of flood insurance. As noted above, the Agencies have revised and are re-proposing question and answer 60, which addresses when a lender should send the force-placement notice, and question and answer 62, which addresses when a lender may charge a borrower for the cost of flood insurance during the 45-day notice period. The Agencies are also proposing revisions to final question and answer 57 in consideration of the proposed revisions to questions and answers 60 and 62.

Comments and Revised Proposed Question and Answer 60

On July 21, 2009, the Agencies proposed question and answer 60 to address the permissibility of a lender's acceleration of the 45-day notice period for force placement by sending notice to the borrower before the borrower's flood insurance coverage expires. The Act provides that a lender or its servicer must notify a borrower if it determines that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property. The Act further provides that if the borrower fails to purchase flood insurance within 45 days of such notice, the lender or servicer is required to purchase the insurance on behalf of the borrower. See 42 U.S.C. 4012a(e)(1) & (2). The proposed answer to question 60 stated that although a lender or servicer could send an advance notice, the Act and Regulation do not allow a lender or its servicer to shorten the 45-day force-placement notice period by sending a notice to the borrower prior to the actual expiration date of the flood insurance policy. The proposed answer also provided that the notice must allow the borrower 45 days in which to obtain flood insurance.

The Agencies received a number of comments on this question and answer. A few commenters generally agreed with the proposed answer to question 60; however, the majority of the commenters viewed the proposed question and answer as thwarting the flood insurance program's primary purpose of ensuring continuous flood insurance coverage during the life of the loan.

Some commenters asserted that the proposed question and answer contradicted the NFIP Flood Insurance Manual, which requires flood insurance protection for the life of the loan and states that renewal/expiration letters should be sent not less than 45 days before policy expiration. However, that discussion referenced in the manual pertains to the renewal notice that is sent by an insurance company to policyholders, reminding them that their flood insurance coverage is about to lapse. As such, it has no application to the question and answer, which pertains to the notice that a lender or its servicer is required to send to borrowers once the lender or its servicer has made a determination that flood insurance coverage has either lapsed or is inadequate.

The Agencies agree with the commenters that the purpose of the notice process is to ensure that there is continuous flood insurance coverage during the life of the loan. In considering these comments to proposed question and answer 60, the Agencies have sought to reconcile the statute's requirement that a lender send the borrower notice of inadequate or lapsed flood insurance with the purpose of the statute to facilitate a lender or servicer's ability to ensure continuous flood insurance coverage. The Agencies are, therefore, proposing revisions to question and answer 60 to clarify when a lender is required to send a force placement notice to the borrower to ensure adequate flood insurance coverage is maintained throughout the term of the loan. The revisions to the question and answer are further made in recognition of the position, set out in the revisions to proposed question and answer 62 *infra*, that lenders may force place flood insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance is in effect and charge the borrower for the costs of such coverage, if the borrower has given the lender express authority as a contractual condition of the loan being made.

The text of the revised proposed question and answer is as follows:

60. When should a lender send the force placement notice to the borrower?

Answer: To ensure that adequate flood insurance coverage is maintained throughout the term of the loan, a lender or its servicer must notify a borrower whenever flood insurance on the collateral has expired or is less than the amount required for the property. The lender must send this notice upon making a determination that the flood insurance coverage is inadequate or has expired, such as upon receipt of the notice of cancellation or expiration from the insurance provider or as a result of an internal flood policy monitoring system. Notice is also required when a lender learns that a property requires flood insurance coverage because it is in an SFHA as a result of a flood map change (which is occurring in many communities as a result of FEMA's map modernization program). To avoid the expiration of insurance, the Agencies recommend that the lender also advise the borrower when flood insurance on the collateral is about to expire.

Comments on Revised Proposed Question and Answer 62

On July 21, 2009, the Agencies proposed question and answer 62 to address whether a borrower may ever be charged for the cost of flood insurance that provides coverage for the 45-day force-placement notice period. The Agencies received comments from 19 commenters regarding the proposed question and answer. Of these, a majority disagreed with the proposition that a lender or servicer has no authority to charge a borrower for coverage that applies to the notice period. One commenter favored the question and answer, but noted that gaps in coverage and costly administration of the notice requirements would be eliminated if lenders escrowed flood insurance premiums, even though not legally required to do so. Another commenter had no objection to the proposed question and answer.

Several commenters reasoned that the Act intended to establish a goal of continuous coverage throughout the life of a mortgage loan. These commenters contended that question and answer 62 would undercut this primary goal if finalized as proposed.

Commenters also contended that a borrower must maintain flood insurance at the borrower's expense throughout the life of the loan. They argued that it is in the borrower's best interest if flood insurance coverage on the collateral is purchased by the lender during the 45-day notice period after a policy lapses if a borrower has not renewed the policy or otherwise purchased insurance. A commenter contended that it is fair and equitable that borrowers should pay for continuous coverage. Some commenters also noted that the Act expressly allows a lender to charge a borrower for the cost of premiums and fees incurred in purchasing insurance. One commenter argued it would further safety and soundness principles to allow a lender or a servicer to charge a borrower for the cost of flood insurance during the notice period because, otherwise, the lender may not purchase such coverage if it could not recoup its cost. Another commenter did not address the proposed question and answer directly, but did argue for continuous flood insurance coverage throughout the life of a mortgage, including the notice period, citing potential significant financial risk to a borrower during that time.

Some commenters acknowledged that the Act does not specifically authorize a lender or a servicer to charge a borrower for a force-placed policy until the notice period has expired. However, these commenters contended that, absent a specific prohibition on charging borrowers for coverage for the 45-day notice period, lenders should be permitted to charge borrowers for such coverage.

Several commenters contended that most loan agreements generally prohibit any gap in flood insurance coverage and authorize a lender to force place insurance on the collateral if the borrower fails to maintain coverage. One commenter advised that the proposed question and answer would interfere with the borrower-lender contractual relationship and also with the purpose of the Act by prohibiting lenders from relying on the authority granted in their loan documents to force place flood coverage.

One commenter noted that a policy force-placed through the NFIP is not available until the expiration of the notice period; others contended that private insurers offer force-placed coverage effective retroactively to the date of the lapse to avoid any uninsured loss. With respect to coverage during the notice period, one commenter noted that, if retroactive coverage to the date of lapse is not permitted for a force-placed private insurance policy, the lender (and the borrower) will be exposed to loss. Several commenters noted that the lender would be exposed to at least a 15-day lapse in coverage under an NFIP policy because the lender's coverage continues for only 30 days after lapse, not 45.

Several commenters maintained that proposed question and answer 62 could harm borrowers. Commenters argued that a borrower would not have to pay for duplicate coverage under most force-placed policies. They contended that an insurer would waive or refund the premiums for force-placed insurance if the borrower establishes that coverage is already in place or was obtained during the notice period. Several commenters even argued that the proposed question and answer might encourage a "free-rider situation" in which borrowers may delay renewal or even cancel policies since they cannot be charged during the notice period.

A few commenters argued that proposed question and answer 62 could lead to increased losses for the NFIP since lenders would submit more claims under the mortgagee clauses of the NFIP policy for losses that occur during the notice period instead of submitting them to a private force-placed policy. The same commenters maintained that smaller lenders may not be able to afford the cost of blanket or force-placed policies and will allow collateral to remain uninsured for the gap period, contrary to safety and soundness principles.

In consideration of the comments received, the Agencies are revising proposed question and answer 62. As a general rule, the revised proposed question and answer would allow a lender or its servicer to charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance coverage is in effect <u>if</u> the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made. Any policy that is obtained by a lender or its servicer, the premium of which is charged to the borrower pursuant to a contractual right, should be equivalent in coverage and exclusions to an NFIP policy and cover the interests of both the borrower and the lender.

In the proposed question and answer, the Agencies also encourage institutions to explain their force-placement policies to borrowers (including their policy on charging for force-placement coverage for the 45-day period and the timing of that charge) and encourage lenders and servicers to escrow flood insurance premiums. Following these recommendations could result in significantly less force placement of flood insurance. The Agencies also note in the proposed question and answer that Regulation Z requires lenders to establish an escrow account for the payment of property taxes and mortgage-related insurance required by the lender, including flood insurance, for all "higher priced" first-lien mortgage loans. *See* 12 CFR 226.35(b)(3).[7]

The text of the revised proposed question and answer follows:

62. When may a lender or its servicer charge a borrower for the cost of insurance that covers collateral during the 45-day notice period?

Answer: A lender or its servicer may charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance coverage is in effect, if the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made. Any policy that is obtained by a lender or its servicer, the premium of which is charged to the borrower pursuant to a contractual right, should be equivalent in coverage and exclusions to an NFIP policy and cover the interests of both the borrower and the lender.

The Agencies encourage institutions to explain their force-placement policies to borrowers (including their policy on charging for force-placement coverage for the 45-day period and the timing of that charge) and encourage lenders and servicers to escrow flood insurance premiums. Following these recommendations could result in less force placement of flood insurance. Further, Regulation Z requires lenders to establish an escrow account for the payment of property taxes and mortgage-related insurance required by the lender, including flood insurance, for all "higher priced" first-lien mortgage loans. See 12 CFR 226.35(b)(3).

Revised proposed Question and Answer 57

Proposed question and answer 57 provides general guidance on force placement under the Act and Regulation. The Agencies are proposing revisions to previously finalized question and answer 57 as a result of the proposed revisions to questions and answers 60 and 62. The proposed revisions to question and answer 57 clarify when a lender is required to send a force-placement notice to the borrower to ensure adequate flood insurance coverage is maintained throughout the term of the loan. The proposed revisions also clarify best practices that lenders should follow in providing borrowers with useful information in the force-placement notice to assist them in understanding the high costs of premiums and fees in connection with force-placed insurance coverage. The revised question and answer also encourages lenders, in situations where a borrower has not previously been required to have flood insurance (such as a map change), to send borrowers the Notice of Special Flood Hazards and Availability of Federal Disaster Assistance with the force-placement notice to give borrowers important information about the implications of being in a SFHA.

The text of the revised proposed question and answer is as follows:

57. <u>What is the requirement for the force placement of flood insurance under the Act and Regulation?</u>

Answer: The Act and Regulation require a lender to force place flood insurance, if <u>all</u> of the following circumstances occur:

- The lender determines at any time during the life of the loan that the property securing the loan is located in an SFHA;
- Flood insurance under the Act is available for improved property securing the loan;
- The lender determines that flood insurance coverage is inadequate or does not exist; and
- After required notice, the borrower fails to purchase the appropriate amount of coverage within 45 days.

The Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider. The Act and Regulation also require the lender, or its servicer, to give notice and force-place such insurance, if necessary, when a lender learns that a property requires flood insurance coverage because it is in a SFHA as a result of a flood map change (which is occurring in many communities as a result of FEMA's map modernization program).

The notice to the borrower must clearly state that the borrower should obtain, at the borrower's expense, flood insurance in an amount at least equal to the amount required under the NFIP, for the remainder of the loan's term. The notice should also state that if the borrower does not obtain the insurance within 45-days, the lender will purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees to obtain the coverage, which are likely to be more expensive than if the borrower purchases it. The Agencies encourage institutions to explain their force-placement policies to borrowers (including, where applicable, that they charge for force-placement coverage for the 45-day period and the timing of that charge). In situations where a borrower has not previously been required to have flood insurance (such as a map change), it is a best practice to also provide the Notice of Special Flood Hazards and Availability of Federal Disaster Assistance, which give borrowers important information about the implications of being in a SFHA.

If adequate insurance is not obtained by the borrower within the 45-day notice period, then the lender must purchase insurance on the borrower's behalf. Standard Fannie Mae/Freddie Mac documents permit the servicer or lender to add those charges to the principal amount of the loan.

FEMA developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with force-placement procedures. FEMA published these procedures in the Federal Register on August 29, 1995 (60 FR 44881). Appendix A of FEMA's September 2007 *Mandatory Purchase of Flood Insurance Guidelines* sets out the MPPP Guidelines and Requirements, including force-placement procedures and examples of notification letters to be used in connection with the MPPP.

Public Comments

The Agencies invite specific public comment on proposed questions and answers 57, 60, and 62 and are particularly interested in comments regarding proposed question and answer 62. With regard to proposed question and answer 62, the Agencies note that question and answer 62 being proposed today reaches a conclusion that is significantly different from the guidance proposed in July 2009. In the July 2009 proposed guidance, proposed question and answer 62 stated that a lender or its servicer does not have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period. However, in recognition of standard provisions in many contracts entered into between borrowers and lenders at loan origination, the Agencies are now proposing guidance allowing lenders, or servicers acting on behalf of lenders, to charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance coverage is in effect if the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made.

The Agencies are concerned that borrowers are not adequately aware of the higher costs of lender-placed flood insurance. In addition, the Agencies are concerned that borrowers may not be aware that lender force placement may occur during the 45-day notice period and that the borrower could be charged for such coverage. The Agencies invite comment on how to address these concerns and on whether they should adopt question and answer 62 as proposed. The Agencies also seek comment on whether there are alternative approaches that would appropriately balance the borrower's right to obtain flood insurance at any time during the 45-day period after notification and avoid force placement with the lender's need to protect itself during that period and to be compensated for lender-purchased insurance.

The Agencies note that an NFIP flood insurance policy provides coverage for the mortgagee for 30 days after lapse. Proposed question and answer 62 does not directly address whether a lender may charge the borrower for coverage during the 30 days after lapse of the borrower-purchased NFIP policy, during which time the policy is still in effect, other than stating that the lender may charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance coverage is in effect. The Agencies also seek comment on whether any final question and answer on this issue should provide that lenders may not charge for additional overlapping lender-placed coverage during that 30-day period.

Finally, the Agencies note that there are a number of recent developments relating to force-placed insurance on consumer mortgages. For example, Congress recently set forth notice and force-placement requirements for hazard insurance in section 1463 of the Dodd–Frank Act, which amends the Real Estate Settlement Procedures Act of 1974. While section 1463 is still awaiting regulatory implementation, the statutory language provides that a servicer of a federally related mortgage may not impose any charge on any borrower for force-placed hazard insurance unless the servicer has sent the borrower two separate notices within a 45-day period and has not received confirmation from the borrower that such insurance has been obtained during that period. The Agencies note that section 1463 of the Dodd–Frank Act does not cover the force placement of flood insurance. Force-placement of insurance also has been raised as a significant concern in connection with recent foreclosure activity. The Agencies will continue to monitor developments in this area to the extent that they can inform agencies' supervisory policy with regard to the Act rules.

If financial institutions, bank examiners, community groups, or other interested parties have unanswered questions or comments about the Agencies' flood insurance regulation, they should submit them to the Agencies. The Agencies will consider addressing these questions in future guidance.

Solicitation of Comments Regarding the Use of "Plain Language"

Section 722 of the Gramm–Leach–Bliley Act of 1999, 12 U.S.C. 4809, requires the federal banking Agencies to use "plain language" in all proposed and final rules published after January 1, 2000. Although this document is not a proposed rule, comments are nevertheless invited on whether the proposed questions and answers are stated clearly and how they might be revised to be easier to read.

The text of the new final Questions and Answers follows:

Interagency Questions and Answers Regarding Flood Insurance

* * * * *

II. Determining the appropriate amount of flood insurance required under the Act and Regulation

* * * * *

9. What is the "insurable value" of a building?

Answer: The insurable value of a building is the same as the overall value of a property minus the land on which the property is located. FEMA's *Mandatory Purchase of Flood Insurance Guidelines* state that the insurable value of a building is the same as 100 percent replacement cost value (RCV) of the insured building, which is defined as "[t] he cost to replace property with the same kind of material and construction without deduction for depreciation."[8] FEMA's guidelines, however, also provide that lenders should avoid creating a situation in which the insured pays for more coverage than the NFIP would pay in the event of a loss.[9] Strictly linking insurable value to RCV is not practical in all cases. In cases involving certain residential or condominium properties, insurance policies should be written to, and the insurance loss payout usually would be the equivalent of, RCV.[10] However, in cases involving nonresidential properties, and even some residential properties, where the insurance loss payout would normally be based on actual cash value, which is RCV less physical depreciation,[11] insurance policies written at RCV may require an insured to pay for coverage that exceeds the amount the NFIP would pay in the event of a loss. Therefore, it is reasonable for lenders, in determining the amount of flood insurance required, to consider the extent of recovery allowed under the NFIP policy for the type of property being insured. This allows the lender to assist the borrower in avoiding situations in which the insured pays for coverage that exceeds the amount the NFIP will pay in the event of a loss. Lenders need to be equally mindful of avoiding situations in which, as a result of insuring at a level below RCV, they underinsure property.

In calculating the amount of insurance to require, the lender and borrower (either by themselves or in consultation with the flood insurance provider or other appropriate professional) may choose from a variety of approaches or methods to establish the insurable value. They may use an appraisal based on a cost-value (not market-value) approach, a construction-cost calculation, the insurable value used in a hazard insurance policy (recognizing that the insurable value for flood insurance purposes may differ from the coverage provided by the hazard insurance and that adjustments may be necessary; for example, most hazard policies do not cover foundations), or any other reasonable approach, so long as it can be supported.

10. *[Reserved]*

Answer: [Reserved]

* * * * *

X. Force placement of flood insurance

* * * * *

57. *What is the requirement for the force placement of flood insurance under the Act and Regulation?*

Answer: [Reserved]

60. *When should a lender send the force-placement notice to the borrower?*

Answer: [Reserved]

61. *When must the lender have flood insurance in place if the borrower has not obtained adequate insurance within the 45-day notice period?*

Answer: The Regulation provides that the lender or its servicer shall purchase insurance on the borrower's behalf if the borrower fails to obtain flood insurance within 45 days after notification. However, where there is a brief delay in force placing required insurance, the Agencies will expect the lender to provide a reasonable explanation for the delay, for example, where a lender uses batch processing to purchase force-placed flood insurance policies.

62. *When may a lender or its servicer charge a borrower for the cost of insurance that covers collateral during the 45-day notice period?*

Answer: [Reserved]

* * * * *

Dated: June 28, 2011

John Walsh,
Acting Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, September 30, 2011.

Jennifer J. Johnson,
Secretary of the Board.

Dated at Washington, D.C., this 11th day of October, 2011.

FEDERAL DEPOSIT INSURANCE CORPORATION

Valerie J. Best,
Assistant Executive Secretary.

Date: October 5, 2011

Dale L. Aultman,
Secretary,
Farm Credit Administration Board.

By the National Credit Union Administration Board, on October 3, 2011.

Mary F. Rupp,
Secretary of the Board.

[1]Throughout this document "the Agencies" includes the OTS with respect to events that occurred prior to July 21, 2011, but does not include OTS with respect to events thereafter. Sections 311 and 312 of the Dodd-Frank Wall Street Reform and Consumer Protection Act transferred OTS's functions to other agencies on July 21, 2011. The OTS's supervisory functions relating to Federal savings associations were transferred to the OCC, while those relating to state savings associations were transferred to the FDIC. See also 76 FR 39246 (Jul. 6, 2011).

[2]The Agencies' rules are codified at 12 CFR part 22 (national banks) and 76 FR 48,950, 49,140 (Aug. 9, 2011) (to be codified at 12 CFR part 172) (Federal savings associations) (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (state nonmember banks) and 76 FR 47,822 (Aug. 5, 2011) (to be codified at 12 CFR part 391 subpart D) (state savings associations) (FDIC), 12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA). OTS's rules at 12 CFR part 572 will be removed from codification at a later date.

[3]RCV is the cost to replace property with the same kind of material and construction without deduction for depreciation. FEMA, *Mandatory Purchase of Flood Insurance Guidelines,* at GLS 10.

[4]"Actual cash value" is the cost to replace an insured item of property at the time of loss, less the value of its physical depreciation. FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, at GLS 1.

[5]FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, at 27.

[6]A single-family dwelling, including a single-family unit in a building under a condominium form of ownership, used as the insured's primary residence is covered under the NFIP's Dwelling Policy and, upon loss, payment is settled at RCV if the dwelling is insured for at least the lesser of 80 percent of the dwelling's full RCV or the maximum limit of coverage under the NFIP. Losses on other residential properties are settled at actual cash value. *See* FEMA, *Flood Insurance Manual*, at POL 3-20. Residential condominium buildings are covered under the NFIP's Residential Condominium Building Association Policy (RCBAP). Losses on residential condominium buildings are settled at RCV, unless subject to a co-insurance penalty, which applies when the building coverage is less than the lesser of 80 percent of full RCV or the maximum limit of coverage under the NFIP. *See id.* at POL 43-60.

[7]Institutions should note that upcoming rules to implement section 1461 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203) (Dodd–Frank Act), may affect the portion of the answer referencing mandatory escrow requirements for flood insurance.

[8]FEMA, *Mandatory Purchase of Flood Insurance Guidelines,* at GLS 10.

[9]FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, at 27.

[10]A single-family dwelling, including a single-family unit in a building under a condominium form of ownership, used as the insured's primary residence is covered under the NFIP's Dwelling Policy and, upon loss, payment is settled at RCV if the dwelling is insured for at least the lesser of 80 percent of the dwelling's full RCV or the maximum limit of coverage under the NFIP. Losses on other residential properties are settled at actual cash value. *See* FEMA, *Flood Insurance Manual*, at POL 3-20. Residential condominium buildings are covered under the NFIP's Residential Condominium Building Association Policy (RCBAP). Losses on residential condominium buildings are settled at RCV, unless subject to a co-insurance penalty, which applies when the building coverage is less than the lesser of 80

percent of full RCV or the maximum limit of coverage under the NFIP. *See id.* at POL 43-60.

[11] FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, at GLS 1.