The Wisconsin Credit Union League
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Submitted via email to: *regcomments@ncua.gov*

Dec. 29, 2014

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke St.
Alexandria, Virginia 22314-3428

Re: Joint Notice of Proposed Rulemaking, Loans in Areas Having Special Flood Hazards
RIN 3133-AE40

Dear Mr. Poliquin

On behalf of Wisconsin's credit unions® and their 2.5 million members, the Wisconsin Credit Union League welcomes the opportunity to comment on the proposed interagency flood insurance rules.

Through the Biggert-Waters Flood Insurance Reform Act of 2012 and the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA), Congress is imposing significant new compliance obligations on mortgage lenders. We understand that the NCUA and other regulatory agencies have limited jurisdiction over many of these provisions. For instance, we would prefer an increase in the proposal's $1 billion "small lender" exception; it should be consistent with the $2.060 billion (as of Dec. 31, 2014) "small creditor" exemption under the Reg. Z ability-to-repay / qualified mortgage rules. A higher exception would spare many credit unions the significant expenses needed to establish escrow account processes for flood insurance premiums and fees. However, we understand the $1 billion exception is specified in the Flood Disaster Protection Act, as amended, and that the agencies lack authority to change it.

With respect to the provisions over which the agencies do have jurisdiction, the proposal clearly shows that the NCUA and other regulators are doing what they can to ease the compliance burdens facing credit unions. We appreciate their efforts, and we generally support this proposal. Having said that, we believe that the agencies need to clarify or change certain provisions, which the remainder of this letter will address.

<u>Exemption for detached, non-residential structures</u>

It makes sense to exempt detached, non-residential structures from the flood insurance mandates, under proposed §760.4(c) of the NCUA Regulations. However, the following remarks appear in the proposal's section-by-section analysis:

> The exemption would address an area of concern for borrowers and lenders by excluding relatively low-value structures, for example, detached sheds and garages, from mandatory flood insurance coverage if they secure a designated loan. The Agencies understand, however, that some detached structures might be of relatively high value, such as a detached greenhouse. While the statute does not require flood insurance for such structures, as a matter of safety and soundness, lenders may nevertheless require flood insurance on these detached structures.

These remarks prompt two concerns:

- First, the agencies should either 1) eliminate these remarks, 2) amend them to make it clear that requiring insurance for these structures is entirely at the lender's discretion, or 3) explain what they intend "relatively high value" and "relatively low value" to mean. Our concern is that examiners may misapply these remarks to cite credit unions for failing to require flood insurance on detached structures of questionable value as a matter of "safety and soundness."

  Insuring detached structures significantly increases borrowers' flood insurance costs. They need an NFIP Dwelling Form to insure a single residence, but they need a separate General Property Form to insure any non-residential detached structure in a flood zone. (The General Property Form is used to insure five or more family residential buildings and non-residential buildings.) A General Property Form typically carries much higher premiums and deductibles for non-residential buildings, yet it often will not pay on a claim because the loss calculation is based on the structure's depreciated "actual cash value." As a result, General Property Forms can be cost-prohibitive and, in the end, of little benefit to homeowners.

  The final rules' "supplementary information" should include no remarks that might cause examiners to push credit unions to require flood policies on detached, non-residential structures when doing so is not absolutely necessary. Lenders, not examiners, should have the sole discretion to determine the necessity of NFIP coverage for detached structures, based on information they obtain during underwriting. Opening the door for examiners to require such coverage routinely would result in substantially higher flood insurance costs for consumers, counter to Congress' express intent in passing the HFIAA.

  If the agencies will not at least modify these remarks to make clear that insuring non-residential detached structures is the lender's decision, not an examiner's, then the agencies should provide some explanation of what the phrases "relatively high value" and "relatively low value" mean. Without guidance from the agencies, such as official staff commentary, the remarks would be left to the subjective interpretation of individual examiners. Fairness requires consistency in the interpretation and application of this "safety and soundness" standard.

- Second, the agencies should clarify that if a covered credit union chooses to require flood insurance coverage for a detached non-residential structure, despite the exemption, then it should not have to escrow the premiums and fees for that General Property Form. As written, the rule is unclear whether flood insurance premiums and fees related to detached structures may or may not be subject to the escrow requirement.

<u>Definition of "residence"</u>

The agencies requested comments on whether or how they should define "residence" under the exemption for non-residential detached structures. The final rules should define the term, to avoid uncertainty or even litigation. The definition should refer to the type of property, not the loan's purpose. It is irrelevant whether the borrower is using non-residential collateral to secure a business loan, residential mortgage or other consumer purpose loan. Regardless of the loan's purpose, the borrower will not be well-served by a lender's requirement to insure the detached non-residential structure – because of the high costs and questionable benefits of a General Property Form, as described previously.

Section 13 of the HFIAA exempts any structure that is a part of a residential property but is detached from the primary residential structure of such property and does not "serve as a residence." To be consistent with the Act, the regulatory definition should focus on whether the building actually is <u>used</u> as a residence at the time the loan is made. The rules could borrow the approach taken to define "dwelling" in Reg. Z §1026.2(a)(9). The CFPB's Staff Commentary to that definition focuses on a building's actual use:

2. Use as a residence. Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings.

Such an approach preserves a lender's discretion to examine the facts and decide whether a detached structure is actually being used as a residence. It would be too unwieldy to base the definition on whether the building may have been designed to serve as a potential residence.

In addition, the rules should make clear that lenders have no obligation to monitor a detached structure's use to learn whether, at some point during the life of the loan, the building is called into service as a residence. Credit unions cannot be expected to monitor how borrowers use out-buildings and whether they should be re-classified as residences.

Exemption for nonperforming loans

Under the proposal, "nonperforming loans that are 90 or more days past due" would be exempt from the requirement to escrow for flood insurance premiums and fees. The rule should defer to the lender's discretion in classifying loans as non-performing. Basing "nonperformance" on payment status would lead to uncertainty. For example:

- What if a member makes partial payments? When does the 90-day clock start running?

- What if a lender grants a borrower a deferral or modification? Does the 90-day period start at the original payment due date or the deferred due date?

- If the lender offers a grace period, during which payments may be made after a payment due date without incurring a late fee, do the 90 days begin at the end of the grace period?

Furthermore, the proposed rule fails to address whether the escrow requirement may once again apply to a previously nonperforming loan. For example, if a lender approves a borrower's application for a "loss mitigation option" (per the 2014 mortgage servicing rules), or if a delinquent borrower starts making regular loan payments, must the lender re-classify the loan as "performing" and again escrow the flood insurance premiums and fees? The answer should be no. Once the loan is deemed to be nonperforming, it should be permanently exempt from the escrow requirement. Some loans will move in and out of the "exempt" category as borrowers fall behind then make partial payments or cure defaults. Lenders could not hope to comply with the proposed escrow rules for a loan when payments fluctuate that way.

Exemption for subordinate liens

The proposal exempts from the escrow rule any loan "in a 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 §760.3(a)." The final rule should add, at the end of that sentence "at the time the subordinate loan is consummated." This would clarify that the subordinate lender has no continuing obligation to monitor whether the flood policy remains in effect. That obligation falls on the first-lien lender during the life of its loan.

"Small lender" exception transition rules

The proposal excepts "small lenders" from these proposed rules. To qualify, lenders must have total assets of less than $1 billion as of December 1 of either of the two prior calendar years.

In addition, the exception only applies if on or before July 6, 2012, the lender: (i) 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; and (ii) 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 any loans secured by residential improved real estate or a mobile home.

If lenders "outgrow" the $1 billion exception threshold, the proposal would give them just six months to start complying with the escrow rules. As the agencies explained:

> [U]nder the proposal, a regulated lending institution would be required to escrow flood insurance premiums and fees for any loans made, increased, extended, or renewed on or after July 1 of the succeeding calendar year after a regulated lending institution has a change in status.
>
> For example, assume a regulated lending institution qualified for the exception in 2016, but had assets of $1 billion or more as of December 31, 2016, and December 31, 2017. In that case, under the proposal, such regulated lending institution would be required to begin escrowing for any loans made, increased, extended, or renewed on or after July 1, 2018.

A lender that has not escrowed for flood insurance premiums previously will have a mountainous task in preparing to do so. Implementing a flood insurance escrow program will require the institution to have escrow software integrated into its data processing system, train appropriate staff, potentially hire new staff, develop policies and procedures, begin providing necessary notices, start preparing initial and annual escrow account analyses, and so on. This cannot all be accomplished in just six months. At a minimum, we suggest that the agencies allow 12 months (if not more) for a lender to begin escrowing after losing its "small lender" exception.

For the same reasons, a lender should not be required to provide the proposed escrow option notices to existing borrowers (with loans that do not fit any of the escrow exceptions) until at least 12 months after losing its "small lender" exception.

<u>Conclusion</u>

In summary, we welcome the agencies' attempts to craft flood insurance rules that provide some relief to credit unions facing staggering compliance burdens, but several aspects of this proposal should be revised, or at least clarified.

Thank you.

Sincerely,

Paul Guttormsson
Regulatory Counsel & Director of Compliance Services
The Wisconsin Credit Union League