

# CONSUMER COMPLIANCE OUTLOOK®

FOURTH QUARTER 2011  
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A FEDERAL RESERVE SYSTEM PUBLICATION WITH A FOCUS ON CONSUMER COMPLIANCE ISSUES



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## FLOOD INSURANCE COMPLIANCE REQUIREMENTS

KENNETH BENTON, SENIOR CONSUMER REGULATIONS SPECIALIST,  
AND MICHAEL SCHIRALDI, RESEARCH ASSISTANT, FEDERAL RESERVE BANK OF PHILADELPHIA

### INTRODUCTION

According to the Federal Emergency Management Agency (FEMA), “[F]loods are the most common and costly natural disaster in the United States.”<sup>1</sup> In 2011, homeowners throughout the country painfully learned this lesson as they endured devastating flooding that resulted in billions of dollars worth of damage to their properties. Hurricane Irene alone is estimated to have caused between \$7 and \$10 billion in losses, mostly from flooding.<sup>2</sup> These significant losses translate to a significant volume of flood insurance claims. For example, in 2005 Hurricane Katrina resulted in claim payments of \$16.2 billion from the National Flood Insurance Program (NFIP), ranking it as the most expensive flood since the NFIP’s inception in 1968.<sup>3</sup> These dramatic statistics provide a stark reminder to lenders about the importance of understanding and properly complying with federal flood insurance laws and regulations.

This article provides a brief history of the federal flood insurance statutes and regulations, an overview of flood insurance requirements, and a discussion of enforcement.

### THE NFIA AND ITS SUBSEQUENT AMENDMENTS

In response to increased flood damage, the escalating costs of disaster relief for taxpayers, and the unavailability of affordable flood insurance, Congress enacted the National Flood Insurance Act (NFIA) in 1968.<sup>4</sup> The NFIA established the NFIP to address the economic burdens of floods, encourage protective and preventative measures, and reduce the cost of flood insurance.<sup>5</sup> Property located in a flood area where the community participates in the NFIP is subject to the NFIA’s requirements. According to FEMA, “[a]lmost all

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<sup>1</sup> <http://1.usa.gov/facts-fema>

<sup>2</sup> Michael Cooper, “Hurricane Cost Seen as Ranking Among Top Ten,” *New York Times*, August 30, 2011.

<sup>3</sup> <http://1.usa.gov/facts-fema2>

<sup>4</sup> Public Law 90-448, 82 Stat. 572 (August 1, 1968). Codified, as amended, at 42 U.S.C. §4001 et seq.

<sup>5</sup> 42 U.S.C. §4001(a)

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Editors ..... Kenneth Benton  
Sally Burke  
Robin Myers  
Designer ..... Dianne Hallowell  
Research Assistants ..... Micah Spector  
Laura Gleason  
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Suggestions, comments, and requests for back issues are welcome in writing, by telephone (215-574-6500), or by e-mail ([Outlook@phil.frb.org](mailto:Outlook@phil.frb.org)). Please address all correspondence to:

**Kenneth Benton, Editor**  
**Consumer Compliance Outlook**  
Federal Reserve Bank of Philadelphia  
Ten Independence Mall  
SRC 7th Floor NE  
Philadelphia, PA 19106

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# THE COMMUNITY REINVESTMENT ACT AND HUD'S NEIGHBORHOOD STABILIZATION PROGRAM

Theresa Stark, Senior Project Manager, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System

## INTRODUCTION

On April 6, 2011, the Federal Reserve System hosted an *Outlook Live* webinar for over 1,400 registrants on recent amendments to the Community Reinvestment Act (CRA) implementing regulations, which became effective on January 19, 2011.<sup>1</sup> The amendments are intended to encourage financial institutions to participate in the Neighborhood Stabilization Program (NSP) administered by the U.S. Department of Housing and Urban Development (HUD) by allowing favorable CRA consideration for these activities.<sup>2</sup> The participants included Theresa Stark, who discussed the CRA changes from a regulatory perspective; Mike Griffin, senior vice president of Key Bank, who provided a banker's perspective on the changes; and Matt Perrenod, chief lending officer of the Housing Partnership Network, Inc., who discussed the opportunities available to the industry using NSP dollars.

As a follow-up to the webinar, we are publishing answers for some of the questions that registrants e-mailed to *Outlook Live*.

## BACKGROUND

In December 2010, the federal bank and thrift regulatory agencies (agencies) jointly announced amendments to the CRA regulations that support stabilization of communities affected by high foreclosure levels.<sup>3</sup> Through the NSP, HUD provided funds to state and local governments and nonprofit organizations for the purchase and redevelopment of abandoned and foreclosed properties.

The agencies' final rule reflects the broad support expressed in public comments for the agencies' proposal to expand existing CRA consideration for neighborhood stabilization activities. NSP-eligible activities will receive favorable consideration under the new rule if conducted no later than two years after the date the grantee is required to spend the NSP program funds.

Allowing banking institutions to receive CRA consideration for NSP-eligible activities in additional NSP-targeted areas serves the purposes of the CRA and creates an opportunity to build upon government programs in areas with high rates of foreclosure and vacancy. CRA consideration is not limited

<sup>1</sup> The webinar and presentation slides are available on the *Outlook Live* website: <http://bit.ly/cra-nsp>.

<sup>2</sup> Detailed information on the NSP is available on HUD's website: <http://1.usa.gov/hud-nsp>.

<sup>3</sup> The agencies jointly published a final rule in the *Federal Register* on December 20, 2010, which is available at: <http://1.usa.gov/cra-nsp-reg>.

to activities actually receiving NSP funds and may include other eligible activities in NSP plan areas.

### CRA AMENDMENTS RELATED TO NSP

The definition of “community development” in the CRA regulations was amended to include loans, investments, and services that support, enable, or facilitate projects or activities that (1) meet the eligible uses criteria in the Housing and Economic Recovery Act of 2008 (HERA)<sup>4</sup> and (2) are conducted in designated target areas identified in NSP plans approved by HUD. See \_\_.12(g)(5). Section 2301(c)(3) of HERA established five eligible uses for NSP funds:

- establishing financing mechanisms (such as soft second mortgages, loan-loss reserves, and shared equity arrangements) to purchase and redevelop homes or residential properties that have been foreclosed upon;
- purchasing and rehabilitating properties that have been abandoned or foreclosed upon in order to sell, rent, or redevelop those homes or properties;
- establishing and operating land banks for homes and residential properties that have been foreclosed upon;
- demolishing blighted structures; and
- redeveloping demolished or vacant properties.<sup>5</sup>

Under §2301 of HERA, NSP plans approved by HUD must designate “areas of greatest need” for targeting these eligible activities to address the adverse consequences of high foreclosure levels. In identifying areas of greatest need, HUD must consider the number and percentage of home foreclosures, homes financed by a subprime mortgage, and homes in default or delinquency in each state or local government area. These areas may include middle-income areas, and, as such, activities in those areas are not typically eligible for CRA consideration. By allowing CRA consideration of NSP-eligible activities in NSP target areas, the amendments to the CRA regulations are intended to create opportunities for local governments to leverage government funding by encouraging financial institution participation.

In addition to allowing for CRA consideration of NSP activities in middle-income areas, the amendments to the rule recognize that many of the foreclosed residential properties owned by an institution may be in locations outside its CRA assessment area. If an institution has adequately met the community development needs of its assessment area, it may receive favorable consideration for NSP activities conducted outside its assessment area.

This expanded consideration for NSP activities under the final rule will be available for up to two years after the last date on which grantees are required to spend appropriated funds for the NSP program. See \_\_.12(g)(5)(ii).

### QUESTIONS AND ANSWERS

#### 1. Which neighborhoods qualify for NSP funds?

The vast majority of NSP-targeted areas are listed on a map database on HUD’s website: <http://www.hud.gov/nspmmaps>. Some geographies are in HUD-approved state NSP1 plans but are not listed on the website. Information about those areas can be found in the individual plans.

#### 2. Would lenders receive full assessment-area-level credit for providing funding to third-party intermediaries such as LISC or Enterprise that subsequently fund NSP projects?

The CRA regulations have always allowed financial institutions to receive CRA consideration for activities conducted through a third party or intermediary. Nothing in the NSP amendments would prevent a financial institution from conducting NSP-eligible activities through an intermediary.

#### 3. Are there examples of communities or markets engaging in the private purchase of notes?

Organizations working in communities with high levels of foreclosed properties need to conserve the limited subsidies available through programs such as the

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<sup>4</sup> Public Law 110–289, 122 STAT. 2654 (July 30, 2008), available at: <http://1.usa.gov/hera-nsp>

<sup>5</sup> NSP2 and NSP3 grants for redevelopment of demolished or vacant properties may be used only for housing. For more information on NSP2 and NSP3 grants, visit: <http://1.usa.gov/hud-nsp>.

NSP. One way to do this is for community development organizations to purchase defaulted notes prior to foreclosure. The Housing Partnership Network, a business collaborative of some 94 housing and community development organizations, has been encouraging servicers and investors to reduce principal balances in loan modifications. Mission-driven community organizations are beginning to purchase loans from loan pools so that they can work with borrowers to modify them and avoid foreclosure. In cases where homeowners cannot afford a modification, purchasing the note allows these community organizations to take possession of the home before it becomes vacant, avoiding the vandalism and theft that unnecessarily devalue properties.

AS LONG AS THE FINANCIAL INSTITUTION HAS DONE AN ADEQUATE JOB OF HELPING TO MEET THE COMMUNITY DEVELOPMENT NEEDS OF ITS ASSESSMENT AREA, IT CAN RECEIVE CRA CONSIDERATION FOR NSP-RELATED ACTIVITIES OUTSIDE ITS ASSESSMENT AREA AS IF THEY WERE DONE INSIDE THE AREA.

Purchasing and modifying delinquent loans takes time, and patient capital is needed to fund the effort; however, some communities are making progress in this effort. One example is Oregon, where a plan to purchase notes was approved by the Treasury using the Hardest Hit Fund, part of the Troubled Asset Relief Program funds. While approximately 19 states assist delinquent borrowers, Oregon is the first to buy notes in partnership with not-for-profit organizations (Mercy Housing and Enterprise). Other states, including Arizona, New Jersey, Illinois, and Ohio, are considering this model.

#### 4. How hard is it to find the owner of a note?

It is easier to find the owner of a note than it used to be. The work done in the last few years on issues related to real estate owned has opened the way. Major servicers

are making the information available to the Neighborhood Community Stabilization Trust and others to enable practitioners to do a reverse look and find the owner of particular notes. It can be challenging to purchase securitized notes because servicers' authority varies with respect to the disposition of assets. Nonetheless, as the government-sponsored enterprises are increasingly taking control of delinquent assets they guaranteed, a good pool of assets is now available from Fannie Mae and Freddie Mac.

#### 5. Can you provide examples of NSP projects that qualify under the CRA, specifically in areas with high foreclosure rates?

One example discussed in the presentation was Opportunity Homes–Cleveland. This \$8 million project focuses NSP dollars on six neighborhoods in Cleveland. It will redevelop 121 vacant homes for sale, demolish 100 vacant and blighted structures, and keep 100 families who are at risk of foreclosure in their homes. The project targets buyers at 60 to 120 percent of area median income (AMI), which is above the threshold of 80 percent of AMI under CRA.

#### 6. Are enterprise zones included in the expanded definition, even though, by nature, they are usually more oriented toward business?

The CRA Interagency Questions and Answers specifically state that “examiners will presume that an activity revitalizes or stabilizes a low- or moderate-income geography if the activity has been approved by the governing board of an Enterprise Community or Empowerment Zone...and is consistent with the board’s strategic plan.”<sup>6</sup> Nothing in the amendments to the CRA regarding consideration of NSP-related activities changes the treatment of community development activities conducted in enterprise zones.

#### 7. May a financial institution receive community development consideration for activities in an NSP area

<sup>6</sup> See §\_\_.12(g)(4)(i), 75 Fed. Reg. 11,642, 11,647 (March 11, 2010), available at: <http://www.ffiec.gov/cra/pdf/2010-4903.pdf>.


by affordable housing agencies that do not receive funds from HUD but carry out the activities in an area designated as an area of greatest need? If so, may efforts that serve middle-income geographies and individuals be counted as well?

Yes. The specific aim of the federal banking agencies in amending the CRA was to leverage NSP funds in areas hard hit by foreclosures by expanding the CRA's consideration of NSP-eligible activities in NSP-targeted areas. This means two things: (1) NSP-eligible activities in middle-income areas that HUD has identified as areas of greatest need under the NSP program will receive CRA consideration and (2) NSP-eligible activities conducted outside an institution's CRA assessment area will be considered in its CRA evaluation provided the institution has done an adequate job of meeting the community development needs within its assessment area. Thus, if a community development activity qualifies as an "eligible use" of NSP funds, it is eligible for CRA consideration in NSP target areas, whether or not the particular project is funded with NSP dollars.

**8. Will CRA consideration be the same for activities conducted outside a financial institution's assessment area as inside?**

Yes. As long as the financial institution has done an adequate job of helping to meet the community development needs of its assessment area, it can receive CRA consideration for NSP-related activities outside its assessment area as if they were done inside the area. The preamble to the CRA amendments makes clear that this flexibility was intended to encourage financial institutions to engage in neighborhood stabilization activities in areas outside their CRA assessment area where they make loans.<sup>7</sup> But even if all of a financial institution's lending was done in its assessment area, the CRA regulations have always given consideration to community development activities in a broader statewide or regional area that includes the institution's assessment area.<sup>8</sup> The recent amendments broaden this for NSP-related activities.

#### CONCLUSION

Specific issues and questions about receiving CRA consideration for NSP activities should be raised with your primary regulator. 

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<sup>7</sup> 75 Fed. Reg. 79,278, 79,280 (Dec. 20, 2010).

<sup>8</sup> See \_\_.12(h)(2)(ii).

## SERVICEMEMBERS CIVIL RELIEF ACT - COMPLIANCE UPDATE

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In the Second Quarter 2011 issue of *Consumer Compliance Outlook*, the lead article discussed "Compliance Requirements for the Servicemembers Civil Relief Act." Developments regarding the Servicemembers Civil Relief Act (SCRA) since then warrant this brief update for *Outlook* readers.

#### HUD'S REQUIRED NOTICE OF DISCLOSURE

For all mortgage loans, including conventional mortgages and mortgages insured by the U.S. Department of Housing and Urban Development (HUD), when a borrower defaults, creditors and their servicers must provide HUD's "Servicemembers Civil Relief Act Notice" to the borrower within 45 days. The notice informs the borrower of the rights available to service members under the SCRA. HUD introduced the required notice in Mortgagee Letter

2006-28 (Mortgage and Foreclosure Rights of Servicemembers under the SCRA).

On June 30, 2011, HUD announced a revised "Servicemembers Civil Relief Act Notice Disclosure" form that updates, among other things, the extended time frames associated with the relief afforded to military personnel on active duty. HUD's announcement and a link to the revised disclosure can be found at <http://1.usa.gov/scra-hud>. The revised notice includes the service members' right to not pay an interest rate above 6 percent on a debt incurred prior to entering military service, during the period of military service, and one year thereafter. Additionally, the revised notice advises borrowers of service members' protection from foreclosure proceedings during, or within nine months after, a service member's military service.

## DOJ SETTLEMENTS UNDER THE SCRA

On May 26, 2011, the Department of Justice announced settlements with two lenders under the SCRA to resolve allegations that the lenders wrongfully foreclosed on active duty service members without first obtaining court orders. Under one settlement, a subsidiary of Bank of America Corporation (formerly Countrywide Home Loans Servicing) agreed, among other requirements, to establish a \$20 million fund from which to compensate service members on whom Countrywide allegedly wrongfully foreclosed. Under a second settlement, Saxon Mortgage Services Inc. agreed, among other measures, to establish a \$2.35 million fund to compensate service members on whom Saxon allegedly wrongfully foreclosed. Both lawsuits alleged that the lenders did not consistently check the military duty status of borrowers before initiating foreclosure.

The Department of Justice's complaint alleged that both of these lenders knew or should have known about the military status of a substantial percent of the identified victims. Both lenders agreed under the respective consent orders to check the Defense Manpower Data Center's website and their own files to confirm the service status of all borrowers prior to initiating any foreclosure proceedings.

## DEFENSE MANPOWER DATA CENTER

The Department of Defense hosts the Defense Manpower Data Center (DMDC) to assist lenders in determining if a particular borrower is currently on ac-

tive military duty. The data center can be accessed at <https://www.dmdc.osd.mil/scra/> with the appropriate certificate. With the borrower's name and Social Security number, lenders can use the DMDC to confirm the current military duty status of that individual. Verification of a borrower's military service status before initiation of foreclosure proceedings is considered a mortgage servicing best practice.

Lenders may also consider contracting with one of the private vendors that perform this verification on behalf of mortgage servicers and creditors. In cases where a lender has a larger number of verifications to perform, the bulk verification services of these vendors can provide cost-effective alternatives for review of an entire portfolio of loans.

## NEW SCRA EXAMINATION PROCEDURES

On August 15, 2011, the Federal Reserve issued revised SCRA examination procedures to incorporate recent amendments to the Housing and Economic Recovery Act. The amendments extended certain SCRA protections that were to expire on December 31, 2010 until December 31, 2012. In particular, the provision for an extended time period beyond active military duty (from 90 days to nine months) for protections affecting foreclosure, sale, or seizure of real or personal property remains effective until December 31, 2012. The revised examination procedures can be accessed at <http://1.usa.gov/frb-scra>.

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## FLOOD INSURANCE COMPLIANCE REQUIREMENTS

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of the nation's communities with serious flooding potential have joined the NFIP."<sup>6</sup>

Flood insurance compliance requirements for federally regulated financial institutions began in 1973, when Congress enacted the Flood Disaster Protection Act of 1973 (FDPA).<sup>7</sup> Section 102(b) of the FDPA amended the NFIA to require the federal banking agencies (agencies) to issue regulations directing lending institutions under their supervision not to make, increase, extend, or renew any loan secured by improved real estate or a mobile home located, or to be located, in a special flood hazard area (SFHA) where flood insurance is available under the NFIP, unless the building or mobile home and any personal property securing the loan are covered by flood insurance for the term of the loan.

Congress subsequently enacted the National Flood Insurance Reform Act of 1994 (NFIRA),<sup>8</sup> which made comprehensive changes to the NFIA and the FDPA. The changes include obligating lenders to escrow all premiums and fees for flood insurance required under the NFIA and its implementing regulations, applying flood insurance requirements to loans purchased by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), and directing the federal banking agencies to jointly issue uniform implementing regulations for common statutory and supervisory requirements for

the institutions they supervise.<sup>9</sup> In response to the last requirement, the agencies published substantially similar flood insurance regulations to implement the statutory requirements of the NFIA, the FDPA, and the NFIRA for the institutions they supervise.<sup>10</sup>

The agencies and the Farm Credit Administration (FCA) have provided additional guidance about flood insurance requirements for the institutions they supervise in the Interagency Questions and Answers Regarding Flood Insurance (Interagency Flood Q&As). In 2009, the agencies and the FCA, in coordination with FEMA, updated this guidance and included five new proposed Q&As.<sup>11</sup> In October 2011, the agencies and the FCA made two of the questions final, withdrew one, and sought additional comments on the other two questions regarding forced placement.<sup>12</sup>

### GENERAL COMPLIANCE REQUIREMENTS

#### *Flood Hazard Area Determination*

Before making a loan secured by a residential or non-residential building or mobile home, a federally regulated lending institution must determine whether the structure is located, or will be located, in an SFHA for which flood insurance is available under the NFIP.<sup>13</sup> This requirement applies even if a creditor takes a security interest simply out of an "abundance of caution." Question 41 of the Interagency Flood Q&As makes it clear that "if the lender takes a security inter-

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<sup>6</sup> National Flood Insurance Program, *Answers to Questions About the NFIP*, Q. 26, FEMA F-084 (March 2011). The list of participating communities is available at: <http://www.fema.gov/fema/csb.shtm>.

<sup>7</sup> Pub. L. No. 93-234, 87 Stat. 975. (1973), available at: <http://1.usa.gov/fdpa73>

<sup>8</sup> Title V of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325 (September 23, 1994), available at: <http://1.usa.gov/1994-reform>

<sup>9</sup> See 42 U.S.C. §4012a(b)(3) (government-sponsored enterprises for housing), 42 U.S.C. §4012a(d)1) (escrow of flood insurance payments), and 12 U.S.C. §4803(a)(3) (streamlining regulatory requirements).

<sup>10</sup> The agencies' flood insurance implementing regulations are codified at 12 C.F.R. §208.25 (Regulation H) for institutions supervised by the Board of Governors of the Federal Reserve System (Board); 12 C.F.R. part 172 for institutions supervised by the Office of the Comptroller of the Currency; 12 C.F.R. part 339 for institutions supervised by the Federal Deposit Insurance Corporation; and 12 C.F.R. part 760 for institutions supervised by the National Credit Union Administration. This article makes reference to the flood insurance requirements of the Board's implementing regulation, but the other agencies' regulations are substantially similar.

<sup>11</sup> 74 Fed. Reg. 35,914 (July 21, 2009), available at: <http://1.usa.gov/flood-2009>

<sup>12</sup> 76 Fed. Reg. 64,175 (October 17, 2011), available at: <http://1.usa.gov/flood-2011>

<sup>13</sup> "Regulated lending institution" is defined in the NFIA as "any bank, savings and loan association, credit union, farm credit bank, Federal land bank association, production credit association, or similar institution subject to the supervision of a Federal entity for lending regulation." 42 U.S.C. §4003(a)(10)

## NEWS FROM WASHINGTON: REGULATORY UPDATES

**Agencies issue policy statement to clarify supervisory and enforcement responsibilities for federal consumer financial law.** On November 17, 2011, the four federal prudential regulators — the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration — and the Consumer Financial Protection Bureau (CFPB) issued a supervisory statement to clarify how and when they will determine the total assets of an insured depository institution or an insured credit union for purposes of their supervisory and enforcement responsibilities. Under §1025 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the CFPB has exclusive authority to examine for compliance with federal consumer financial laws and primary authority to enforce those laws for institutions with total assets of more than \$10 billion and their affiliates. Section 1026 confirms that the four prudential regulators retain supervisory and enforcement authority for other institutions. The policy statement clarifies the measure to determine asset size and the schedule for making such determinations. After an initial asset size determination based on call report data as of June 30, 2011, an institution generally will not be reclassified unless four consecutive quarterly reports indicate that a change in supervisor is warranted. The joint announcement and the policy statement are available at: <http://1.usa.gov/threshold-cfpb>.

**The CFPB releases the first edition of its supervision and examination manual.** On October 13, 2011, the CFPB released version 1.0 of its supervision and examination manual, which is divided into three parts. The first part discusses the CFPB's supervision and examination process, the second part outlines examination procedures, and the third part contains templates that CFPB staff will use in documenting information about supervised entities, including a template for CFPB examination reports. The manual reviews the statutes and implementing regulations that the CFPB enforces for the institutions it supervises, and

the CFPB's examination procedures for these laws, including the Equal Credit Opportunity Act; §1031 of the Dodd-Frank Act (unfair, deceptive, or abusive acts or practices); the Home Mortgage Disclosure Act; the Truth in Lending Act; the Real Estate Settlement Procedures Act; the Consumer Leasing Act; the Fair Credit Reporting Act; the Fair Debt Collection Practices Act; the Electronic Fund Transfer Act; the Truth in Savings Act; and the privacy provisions of the Gramm-Leach-Bliley Act. The manual is available on the CFPB's website at: <http://www.consumerfinance.gov/guidance/supervision/manual/>.

**The Federal Financial Institutions Examination Council (FFIEC) announces revisions to the calculation of annual median family income (MFI) data.** On October 19, 2011, the FFIEC announced that beginning in 2012, it will calculate the annual MFI data that are published each June by using data from the U.S. Census Bureau's American Community Survey and will be referred to as FFIEC median family income data. Previously, the MFI was calculated by HUD. MFI data are calculated annually for each metropolitan and nonmetropolitan area using the geographic changes released by the Office of Management and Budget in December of the previous year. These data are used by the agencies to compile Home Mortgage Disclosure Act data and analyses of Community Reinvestment Act examinations. The FFIEC's announcement is available at: <http://www.ffiec.gov/press/pr101911.htm>.

**Agencies release guidance and proposed revisions to Interagency Questions and Answers Regarding Flood Insurance.** On October 14, 2011, the four federal agencies that supervise banks, thrifts, and credit unions, and the Farm Credit System (agencies) published guidance to update the Interagency Questions and Answers Regarding Flood Insurance (Flood Q&As) that were most recently published on July 21, 2009. When the agencies issued this guidance in 2009, they sought comments on proposed questions 9 and 10 for insurable value and question 61 for force placement of flood insurance. The revised guidance makes questions 9 and 61 final and withdraws question 10. In





addition, the agencies requested comments on newly proposed questions 60 and 62 (force placement) and a revision to existing question 57 (force placement) to make it consistent with the other proposed changes. Comments were due by December 1, 2011. *Outlook* discusses the changes in the cover story of the current issue. The *Federal Register* notice and announcement are available at: <http://1.usa.gov/flood-FRB>.

**The Board of Governors of the Federal Reserve System (Board) issues final rule under Regulation B regarding data collection compliance requirements for motor vehicle dealers.** On September 20, 2011, the Board issued a final rule amending Regulation B to provide that motor vehicle dealers are not required to comply with new data collection requirements in the Dodd-Frank Act until the Board issues final regulations to implement the statutory requirements. The Equal Credit Opportunity Act was amended by the Dodd-Frank Act to require creditors to collect information about credit applications made by women- or minority-owned businesses and by small businesses. The provision must be implemented by the CFPB for all creditors except certain motor vehicle dealers who are subject to the Board's jurisdiction. The CFPB previously announced that creditors are not obligated to comply with the data collection requirements until the CFPB issues detailed rules to implement the law. The Board is amending Regulation B to apply the same approach to motor vehicle dealers. The Board's notice can be found at: <http://1.usa.gov/cars-RegB>.

**The CFPB is seeking comments on financial products and services tailored to service members.** On September 7, 2011, the CFPB announced it is seeking comments on consumer financial products and services tailored to service members and their families. The information provided will help the CFPB's Office of Servicemember Affairs (OSA) to develop financial education and outreach initiatives for military families. The Dodd-Frank Act charged the CFPB with educating and empowering service members and their families to make better informed decisions when choosing financial services and prod-

ucts. Input from military families and financial services providers will inform the OSA on education and outreach initiatives. The OSA seeks information on products and services, education, programs, homeowner assistance, and marketing and communication. The press release is available at: <http://1.usa.gov/cfpb-service>.

**The Board announces final rule to repeal Regulation Q.** On July 14, 2011, the Board announced the approval of a final rule to repeal Regulation Q, which prohibits the payment of interest on demand deposits by institutions that are member banks of the Federal Reserve System. The final rule implements §627 of the Dodd-Frank Act, which repealed §19(i) of the Federal Reserve Act in its entirety, effective July 21, 2011. The repeal of §19(i) eliminates the statutory authority under which the Board established Regulation Q and eliminates the Board's published interpretation of Regulation Q by removal of references to Regulation Q found in the Board's other regulations, interpretations, and commentary. The Board's notice is available at: <http://1.usa.gov/repeal-Q>.

**The Board releases lists of institutions subject to, and exempt from, the debit card interchange fee standard.** On July 12, 2011, the Board published lists of institutions that are subject to, and exempt from, the debit card interchange fee standards in Regulation II, which implements provisions of the Dodd-Frank Act. These lists are intended to help payment card networks and others determine which issuers qualify for the statutory exemption from interchange fee standards. The statute exempts a debit card issuer that, together with its affiliates, has assets of less than \$10 billion. The interchange fee standards became effective on October 1, 2011 and will be updated annually by the Board. The Board's notice and a link to the lists of exempt institutions are available at: [www.federalreserve.gov/newsevents/press/bcreg/20110712a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20110712a.htm).

## ON THE DOCKET: RECENT FEDERAL COURT OPINIONS\*

### REGULATION Z – TRUTH IN LENDING ACT (TILA)

**Borrower may rebut TILA presumption of receiving rescission notice through testimony.** *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180 (3d Cir. 2011). For loans subject to rescission, creditors must provide borrowers with TILA disclosures and two copies of the notice of the right to cancel. Failure to comply can extend the right of rescission from three business days to three years. Under §1635(c) of TILA, a borrower's signature acknowledging receipt of TILA disclosures and the right to cancel creates a legal presumption that the borrower received them. In an important ruling, the Third Circuit held that a borrower's testimony can overcome this presumption. The plaintiff sought to rescind two mortgages she obtained from a mortgage broker that were funded by Countrywide and First Magnus Financial. The plaintiff testified that at the loan closing, she signed the acknowledgment form but did not receive the notice until several days later after the funds were disbursed. The trial court instructed the jury that something more than the plaintiff's testimony was required to rebut the presumption that she properly received the notice of the right to cancel. As a result, the jury ruled in favor of the lenders on the TILA claim. The Third Circuit reversed the ruling, holding that the presumption of receipt can be rebutted through the borrower's testimony, leaving it to the jury to assess credibility. The case was remanded for further proceedings.

**Consumer may obtain damages for Fair Credit Billing Act (FCBA) violations without showing detrimental reliance.** *Lyon v. Chase Bank USA, N.A.*, 656 F.3d 877 (9th Cir. 2011). The plaintiff notified Chase Bank (Chase) that his credit card was stolen and disputed several charges resulting from the theft. In violation of the FCBA, Chase failed to respond in writing, treated a disputed amount as delinquent, assessed finance charges on the disputed amount, and reported a delinquency to the consumer reporting agencies. (The FCBA is a section of TILA, 15 U.S.C. §1666-1666j, governing billing disputes for open-end consumer credit accounts.) The plaintiff filed suit for damages. Chase admitted that its actions violated the FCBA but argued that a plaintiff alleging TILA violations must establish reliance on inaccurate disclosure and resulting harm. The Ninth Circuit held that the requirement to prove detrimental reliance does not apply to FCBA violations because the FCBA addresses billing disputes, so there is no disclosure or conduct involved on which the plaintiff could have relied. The case was remanded for further proceedings.

### FAIR HOUSING ACT AND EQUAL CREDIT OPPORTUNITY ACT

**Claims that discretionary pricing had a disparate impact on mortgage loan applicants cannot be resolved on a class-wide basis.** *Rodriguez v. National City Bank*, --- F. Supp. 2d ---, 2011 WL 4018028 (E.D. Pa. Sept. 8, 2011). The plaintiffs sued National City Bank and National City Corporation alleging that they violated the Fair Housing Act and the Equal Credit Opportunity Act by allowing loan officers pricing discretion for mortgages that had a disparate impact on minority loan applicants. The parties had reached a proposed settlement agreement. However, while the trial court was considering the settlement, the Supreme Court decided *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), a landmark class-action case. The trial court noted that under *Dukes*, allegations of employment discrimination on the basis of gender could not be resolved on a class-wide basis but would have to be made on a supervisor-by-supervisor basis because each supervisor at Wal-Mart exercised discretion in employment decisions. Applying *Dukes*, the court found each loan officer would likely have different explanations of how pricing discretion was exercised for loan applications. Because



the issues in the case would vary by loan officer, the case could not be resolved on a class-wide basis and class certification was denied.

#### FAIR CREDIT REPORTING ACT (FCRA)

**Lawsuit against lender for furnishing inaccurate credit information is dismissed because consumer did not initiate dispute through consumer reporting agency.** *Simmisparris v. Countrywide Financial Corp.*, 652 F.3d 355 (3d Cir. 2011). The Third Circuit affirmed the dismissal of a lawsuit alleging that a furnisher of credit information violated the FCRA by failing to correct the inaccurate information it furnished to four consumer reporting agencies. The plaintiff obtained a mortgage loan from Countrywide Home Loans. Countrywide reported to four agencies that the plaintiff had made two late payments. The plaintiff asked her counsel to send letters to Countrywide disputing the late payments. Countrywide continued to report the payments as late, and the consumer filed a lawsuit alleging FCRA violations and state law claims. The Third Circuit affirmed the dismissal of the lawsuit. Under §1681s-2(a) of the FCRA, a furnisher has a duty to report accurate information to the consumer reporting agencies. However, there is no private cause of action for a §1681s-2(a) violation; this section is subject only to administrative enforcement. Another provision of the FCRA, §1681s-2(b), permits a consumer to file a lawsuit when inaccurate information is furnished, but this section requires the consumer to initiate the dispute with the consumer reporting agencies to which the disputed information was furnished. The agencies then notify the furnisher, which must investigate the dispute and report the results of its investigation to the agencies. Because the plaintiff did not file a dispute with the four consumer reporting agencies, Countrywide's duty to investigate was not triggered for purposes of filing a lawsuit under §1681s-2(b).

It should be noted that Congress amended §1681s-2(a)(1) to require the federal banking agencies to issue regulations allowing consumers to file direct disputes with furnishers. In July 2009, the agencies issued those regulations, which became effective July 1, 2010. The Third Quarter 2010 issue of *Outlook* discussed the obligations of furnishers under the new direct dispute rules. The federal banking agencies enforce compliance with the new direct dispute rules, but there is no private cause of action. In other words, even under the new law, the consumer's lawsuit would have been dismissed.

#### FAIR DEBT COLLECTION PRACTICES ACT (FDCPA)

**Debt collector may not imply that it will report debts over seven years old to a credit bureau.** *Gonzales v. Arrow Financial Services, LLC*, 600 F.3d 1055 (9th Cir. 2011). The Ninth Circuit affirmed a jury award of \$225,500 finding that Arrow Financial Services violated the FDCPA and a similar state law. Arrow, a debt buyer and collector, sent letters to 40,000 consumers stating: "Upon receipt of the settlement amount and clearance of funds, and if we are reporting the account, the appropriate credit bureaus will be notified that this account has been settled." The letters also make several other references to credit bureaus. Because the nearly 40,000 debts in question were all more than seven years old, they could not be reported to a credit bureau under the Fair Credit Reporting Act. The Ninth Circuit upheld the verdict, holding that the use of conditional language ("if we are reporting the account") did not insulate Arrow from the charge that the letter misled consumers into believing that Arrow could report an obsolete debt to a credit bureau.

\* Links to the court opinions are available in the online version of *Outlook* at: <http://www.consumercomplianceoutlook.org>.

## FLOOD INSURANCE COMPLIANCE REQUIREMENTS

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est in improved real estate located in an SFHA, flood insurance is required.” Therefore, lenders must consider these requirements when determining if they will take a security interest in a property located in an SFHA.

Lenders must document the flood hazard determination using FEMA’s Standard Flood Hazard Determination Form (SFHDF) and retain a hard or electronic copy of the form throughout the term of the loan.<sup>14</sup> Making a flood determination as early as possible in the loan process is a good practice because it allows time for the borrower to obtain insurance if it is required and for the lender to meet all other obligations that such a determination may trigger.

Lenders often inquire whether they may rely on a prior flood hazard determination for the same property. Under Question 68 of the Interagency Flood Q&As, a lender may rely on its own prior determination when it is increasing, extending, or renewing a loan secured by the property if three conditions are satisfied: 1) the prior determination was made within seven years of the date of the transaction; 2) the SFHDF reflects the basis of the determination; and 3) FEMA has not revised or updated the map affecting the property since the original determination was made.<sup>15</sup> Lenders can determine when the last update was made to a flood map for a particular address from FEMA’s website.<sup>16</sup> A lender may not rely on a determination made by a different lender.<sup>17</sup>

### *Flood Hazard and Insurance Availability Notice*

If a lender determines that property securing the loan is or will be located in an SFHA, the lender must provide a notice to the borrower.<sup>18</sup> This borrower notification requirement applies regardless of whether the community participates in the NFIP. The notice must contain a warning that the property is or will be located in an SFHA; a description of the NFIA’s flood purchase requirements; a statement, where applicable, that flood insurance is available under the NFIP and from private insurers; and a statement on the availability of federal disaster relief assistance. Use of the sample notice form provided in Appendix A of Regulation H is not mandatory but provides lenders with a safe harbor if used.<sup>19</sup> If a lender chooses, it may use its own customized notice, but the notice must contain at least the minimum information required by the NFIA and its implementing regulations.<sup>20</sup> The lender must provide the notice to the borrower within a reasonable time before the transaction is completed.<sup>21</sup> A record (such as a signed copy of the notice or a certified mail receipt) of the borrower’s receipt of the notice must be retained for the term of the loan.<sup>22</sup> In a loan transaction involving multiple borrowers, the lender need only provide notice to one of the borrowers in the transaction.<sup>23</sup> If a mortgage servicer is used, the lender must provide notice to the servicer “as promptly as practicable” after the notice is furnished to the borrower and no later than when the lender transmits other loan data (such as information concerning hazard insurance and taxes) to the servicer.<sup>24</sup>

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<sup>14</sup> 12 C.F.R. §208.25(f)(2)

<sup>15</sup> Interagency Flood Q&A 68

<sup>16</sup> <http://bit.ly/flood-map>

<sup>17</sup> Interagency Flood Q&A 37

<sup>18</sup> §208.25(i)

<sup>19</sup> §208.25(i)(5). The form is in Appendix A of Regulation H, which is available at: <http://1.usa.gov/flood-form>.

<sup>20</sup> Interagency Flood Q&A 80

<sup>21</sup> §208.25(i)(2)

<sup>22</sup> §208.25(i)(3)

<sup>23</sup> Interagency Flood Q&A 73. The bank is permitted to furnish multiple borrowers with notices if it so chooses.

### Amount of Coverage

The required amount of flood insurance for a loan secured by property located in a flood hazard area is the lesser of: (1) the loan's outstanding principal balance; or (2) the maximum amount of coverage available under the NFIA for the particular type of property serving as collateral.<sup>25</sup> The maximum coverage obtainable under the NFIA is the lesser of: (1) the greatest amount of coverage available under the NFIP for the property type securing the loan (i.e., residential, nonresidential); or (2) the overall property value securing the loan minus the value of the land on which it is located (e.g., the property's "insurable value").<sup>26</sup> The maximum coverage caps in an NFIP participating community are \$250,000 for a residential building and \$500,000 for a nonresidential building.<sup>27</sup>

### Insurable Value

Because an NFIP policy will not pay a claim in excess of a property's insurable value, it is important that this value be determined correctly. A miscalculation could cause the lender to inadvertently require the borrower to purchase too much or too little flood insurance, resulting in a violation. For example, if the value of the land is not excluded when determining the insurable value of a home or building, the borrower will purchase coverage exceeding the amount the NFIP will pay for a covered loss.<sup>28</sup>

To provide greater clarity about insurable value, the agencies issued a proposed definition in their revisions to the Interagency Flood Q&As in 2008 that linked the definition of insurable value to replacement cost value (RCV). However, some commenters expressed concern that the proposed definition could overstate the value in certain circumstances. In particular, for certain nonresidential properties, the NFIP pays only actual cash value, which FEMA defines as the cost to replace an

item at the time of loss less depreciation. Actual cash value would be less than RCV so if a creditor required insurance based on RCV for these types of properties, the borrower would be overinsured.

In response to this concern, the agencies and the FCA revised the final definition of insurable value in October 2011. Interagency Flood Q&A 9 clarifies that RCV should *not* be used as a proxy for insurable value for properties whose insurance loss payout would ordinarily be based on actual cash value:

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. 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, 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.*<sup>29</sup>

The guidance further states that when this occurs, lenders may choose from any reasonable approach to calculate insurable value, as long as it can be supported. The guidance provides examples of permissible methods, including appraisal based on a cost-value (not market-value) approach, a construction-cost calculation, and the insurable value used in a hazard insurance policy.<sup>30</sup>

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<sup>24</sup> §208.25(i)(2). Notice to the servicer may be made electronically or may take the form of a copy of the notice to the borrower. A copy of the notice must also be retained by the lender for the duration of the loan. See also Interagency Flood Q&A 75.

<sup>25</sup> §208.25(c)(1)

<sup>26</sup> Interagency Flood Q&A 8

<sup>27</sup> Interagency Flood Q&A 8. In participating communities that are under the emergency program phase, the coverage caps are \$35,000 for residential dwellings and \$100,000 for nonresidential structures.

<sup>28</sup> Interagency Flood Q&A 8

<sup>29</sup> Interagency Flood Q&A 9, 76 Fed. Reg. 64, 175, 64.182 (Oct. 17, 2011) (emphasis added)

<sup>30</sup> Interagency Flood Q&A 9

### ***Escrowing Flood Insurance Premiums and Fees***

If a creditor requires escrow accounts for loans secured by residential real estate or mobile homes, the creditor must also require the escrow of all premiums and fees for flood insurance required under the NFIA and its implementing regulations.<sup>31</sup> Section 208.25(e) authorizes state member banks, or servicers acting as their agents, to deposit the funds earmarked for flood insurance premiums and fees into the escrow fund on the borrower's behalf. The bank or its servicer is then required to make payments for the borrower's flood insurance premiums from the escrow account as they become due.<sup>32</sup>

### ***Forced Placement of Flood Insurance***

The Interagency Flood Q&As provide detailed guidance on the requirements for forced placement of flood insurance. If at any time during the term of the loan a lender or its servicer determines that the collateral has less flood coverage than is required by the agencies' implementing regulations, it must notify the borrower to obtain the required insurance. The notice should 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.<sup>33</sup> If the borrower has not purchased the necessary flood insurance 45 days after the notice was sent, the lender must purchase insurance on the borrower's behalf.<sup>34</sup> A servicer or lender may add the premium and fee charges to the principal amount of the loan.<sup>35</sup> A lender may comply with the forced-placement requirement by purchasing an NFIP Standard Flood Insurance Policy in the amount

required by the implementing regulations.<sup>36</sup> Appendix A of FEMA's September 2007 *Mandatory Purchase of Flood Insurance Guidelines* sets out the Mortgage Portfolio Protection Program (MPPP) Guidelines and Requirements, including forced-placement procedures and examples of notification letters to be used in connection with the MPPP. Lenders seeking further assistance with implementing forced-placement procedures should consult FEMA's MPPP.<sup>37</sup>

The agencies and the FCA recently provided guidance on when forced-placement insurance must become effective. In October 2011, the agencies issued final Interagency Flood Q&A 61, which states that if a borrower fails to obtain insurance within 45 days after notification, the agencies expect the lender to have insurance in effect on the 46th day. If there is a brief delay, for example, because of batch processing, the agencies expect the lender to provide a reasonable explanation for the delay.<sup>38</sup>

One concern for lenders is their exposure during the 45-day notice period. If a borrower has a policy and fails to renew, the NFIP provides a 30-day grace period to receive the premium, so lenders are covered for the first 30 days. The NFIP will honor a claim for a loss during the grace period as long as the full renewal premium is paid by the end of the 30-day period.<sup>39</sup> However, if the premium is not paid after 30 days, the policy lapses, and the lender has exposure until a policy is obtained. Some lenders rely on blanket insurance (also known as gap insurance) to cover this risk. Interagency Flood Q&A 64 provides that a lender may use blanket or gap insurance to protect itself during the 45-day interim period before a forced-placed in-

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<sup>31</sup> Section 208.25(e)

<sup>32</sup> Funds escrowed in connection with designated loans remain subject to the escrow requirements of Regulation X, 24 C.F.R. §3500.17.

<sup>33</sup> Interagency Flood Q&A 57. See also proposed Q&A 57. 76 Fed. Reg. 64,175, 64,182 (Oct. 17, 2011).

<sup>34</sup> §208.25(g)

<sup>35</sup> Interagency Flood Q&A 57

<sup>36</sup> Interagency Flood Q&A 63. Additionally, a private flood insurance policy may be an adequate substitute for NFIP insurance if it meets the criteria set forth by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines*.

<sup>37</sup> <http://1.usa.gov/fema-mppp>

<sup>38</sup> Interagency Flood Q&A 61. 76 Fed. Reg. 64,175, 64,181 (October 17, 2011)

<sup>39</sup> Section H of Appendix A(1) to 44 C.F.R. Part 61.

insurance policy becomes effective. However, the lender is still required to force place the required coverage in a timely manner and cannot rely on a blanket or gap policy as a substitute for an NFIP policy.

Lenders frequently inquire whether they may charge a borrower for the cost of forced-placed insurance obtained during the 45-day notification period. In the October 2011 guidance, the agencies proposed for comment Interagency Flood Q&A 62 to address this issue. The proposed question permits lenders to charge a borrower for the forced-placed insurance obtained during the 45-day period if the borrower provided the lender authority to do this as a contractual condition of making the loan. The comment period for this question closed on December 1, 2011. A final question and answer will be issued in the future.

## SPECIFIC COMPLIANCE REQUIREMENTS

### *Residential Condominiums*

Flood insurance is required for loans secured by an individual residential condominium unit, including a unit in a multi-story condominium complex, if the condominium is located in an SFHA where flood insurance is available under the NFIP. Loans secured by other condominium property are also covered, such as a loan to the condominium association or to a condominium developer.<sup>40</sup>

The NFIP offers a specific insurance policy for a residential condominium complex — defined as a building having 75 percent or more of its floor area in residential use — known as the Residential Condominium Building Association Policy (RCBAP).<sup>41</sup> This policy, which can only be purchased by condominium owners' associations, covers all individual units (including improvements) and common property. Content in the units can also be covered if content coverage is purchased.

The minimum amount of flood insurance for a loan secured by a condominium unit is the lesser of the outstanding principal balance of the loan or the maximum amount available under the NFIP, which is the lesser of:

- the maximum limit for a residential condominium unit; or
- the insurable value allocated to the unit, defined as 100 percent of the RCV of the entire condominium building divided by the number of units.<sup>42</sup>

To facilitate compliance, the Interagency Flood Q&As include a condominium loan example.<sup>43</sup> The example provides that a lender makes a \$300,000 loan secured by a residential condominium unit in a 50-unit condominium building that is located in an SFHA within a participating community, with a replacement cost of \$15 million and which is insured by an RCBAP with \$12.5 million of coverage.

In this example, additional flood insurance is not required because the RCBAP's \$250,000 per unit coverage ( $\$12.5 \text{ million} \div 50 = \$250,000$ ) satisfies the mandatory flood insurance requirement, which is the lesser of: 1) the outstanding principal balance (\$300,000); 2) the maximum coverage available under the NFIP (\$250,000); or 3) 100 percent of the insurable value ( $\$15 \text{ million} \div 50 = \$300,000$ ). Lenders may rely on the replacement cost value and number of units on the RCBAP declaration page when verifying compliance.<sup>44</sup>

If a lender determines that a borrower's unit is not covered by an RCBAP, or that the coverage under an RCBAP is below the minimum amount required by the NFIA, the lender must ensure that the borrower obtains sufficient coverage.<sup>45</sup> The lender should first request that the borrower ask the condominium association to obtain coverage or obtain additional cover-

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<sup>40</sup> Interagency Flood Q&A 26

<sup>41</sup> The FEMA flood manual, updated in October 2011, provides more specific details about the RCBAP, available at: <http://1.usa.gov/fema-condo>.

<sup>42</sup> Under the previous Interagency guidance released in 1997, lenders were permitted to use 80 percent of the building's RCV, divided by the number of units. The current regulatory guidance, however, requires that, effective September 21, 2009, lenders must use 100 percent of the condominium building's RCV when computing an individual unit's insurable value.

<sup>43</sup> Interagency Flood Q&A 28

<sup>44</sup> Effective October 1, 2007, FEMA requires agents to list the RCV on the declaration page along with the number of units. But a lender cannot rely on this information if it has reason to believe that the listed RCV clearly conflicts with other available information. In that case, the lender should notify the borrower of the potential conflict.

<sup>45</sup> Interagency Flood Q&A 28

age sufficient to meet the regulation's requirements. If the association fails to comply, the lender must require the borrower to purchase a FEMA dwelling policy for supplemental coverage or force place the policy if necessary.<sup>46</sup> When both the RCBAP and a dwelling policy cover the same unit, the RCBAP is considered primary insurance. The maximum amount of coverage for a residential condominium unit is \$250,000; therefore, when both an RCBAP and dwelling policy are in place, the policies are coordinated such that the maximum payout is capped at \$250,000.

THE LENDER MUST CALCULATE BOTH THE TOTAL PRINCIPAL BALANCE OF ALL OF THE OUTSTANDING LIENS ON THE PROPERTY AND THE TOTAL AMOUNT OF FLOOD INSURANCE ON THE OTHER SENIOR AND JUNIOR LIEN(S) SECURING THE PROPERTY.

#### *Nonresidential Condominium Associations*

For a nonresidential condominium building, a condominium association must purchase FEMA's general property policy. Both building and contents coverage are available separately, in amounts up to \$500,000 per nonresidential building.<sup>47</sup>

#### *Home Equity Loans and Lines of Credit*

A home equity loan (closed-end credit) or home equity line of credit (open-end credit) secured by a building or mobile home located in an SFHA community that participates in the NFIP is subject to the flood insurance

requirements, regardless of lien priority.<sup>48</sup> Therefore, when a lender makes, increases, extends, or renews a designated home equity loan or line of credit, it must ensure adequate flood insurance is in place taking into account the liens of other creditors on the property.

For home equity loans with multiple lienholders, the required minimum coverage is determined by the same formula used for single-lien designated loans, except that the outstanding principal balance of the designated home equity loan is calculated by adding together the principal balances of each existing loan. Therefore, when the outstanding principal balance of all loans is less than the property's insurable value, a lender making a home equity loan on a property with multiple liens cannot comply with the minimum coverage requirement by simply ensuring that flood coverage for the collateral is at least equal to the outstanding principal balance of its loan to the borrower. The lender must calculate both the total principal balance of all of the outstanding liens on the property and the total

amount of flood insurance on the other senior and junior lien(s) securing the property.<sup>49</sup> Interagency Flood Q&A 36 provides several examples to facilitate compliance. Lenders may obtain a borrower's current credit report to determine the current amounts owed other lienholders.<sup>50</sup>

For home equity lines of credit, a flood determination must be made before the consummation of the loan, but draws against an approved line of credit do not require additional determinations.<sup>51</sup> However, a borrower's request to increase the credit limit on the line

<sup>46</sup> Interagency Flood Q&A 30. While supplementing a borrower's RCBAP coverage with a dwelling policy of the statutorily required amount will satisfy the minimum purchase requirement, the lender and the borrower/unit-owner may still be subject to risk of loss. Specifically, the dwelling policy does not extend the RCBAP's maximum coverage limits. The dwelling policy may also not cover the individual unit-owner's share of the co-insurance penalty. Lenders are encouraged to inform borrowers of this risk.

<sup>47</sup> FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, p. 50, available at: <http://1.usa.gov/flood-purchase>

<sup>48</sup> Interagency Flood Q&A 34

<sup>49</sup> Interagency Flood Q&A 34

<sup>50</sup> Interagency Flood Q&A 36

<sup>51</sup> Interagency Flood Q&A 35



of credit may trigger a new flood insurance determination depending on whether the requirements in Flood Q&A 68 for relying on a previous flood insurance determination are satisfied.

### **Construction Loans**

The Interagency Flood Q&As provide detailed guidance on the flood insurance requirements for construction loans in questions 19-23. If a loan is secured only by land that will later be developed into a buildable lot, flood insurance is not required because the insurance requirements apply only to a loan secured by a building or mobile home.<sup>52</sup> On the other hand, a loan secured by a building in the course of construction is subject to flood insurance requirements, even if the building is not yet walled and roofed, as long as the construction has not been halted for 90 days or longer and/or the lowest floor used for rating purposes is not below the base flood elevation (BFE).<sup>53</sup> When insurance is obtained for a building in the course of construction, materials or supplies used in construction or repair are not insurable unless they are in an enclosed building located on or adjacent to the premises.

The Interagency Flood Q&As offer two compliance options for a lender making a loan secured by a building to be constructed. A lender may require the borrower to acquire a flood insurance policy at the time of origination. Alternatively, a lender may allow a borrower to defer the purchase of flood insurance until either: (1) a foundation slab has been poured and/or an elevation certificate has been issued; or (2) the building is walled and roofed, provided the building to be constructed will have its lowest floor below the BFE.<sup>54</sup> But, before the lender disburses funds for construction (except for pouring the slab or preliminary site work), it must require the borrower to have flood insurance in place. A lender who elects to allow the borrower to defer the purchase of flood insurance until after origination must have adequate internal controls in place

to detect whether either of the above two mandatory purchase triggers has occurred. When any of these triggering conditions occur, the lender must require the borrower to purchase flood insurance or, if necessary, prepare to force place the insurance.<sup>55</sup>

### **TRANSFER OR SALE OF SERVICING RIGHTS**

When a regulated lender originates a designated loan and later transfers or sells the servicing rights to a non-regulated party, but retains ownership of the loan, the regulated lender remains ultimately responsible for fulfilling the flood insurance compliance requirements. The regulated lender must take adequate steps to ensure that the loan servicer will comply with all flood insurance requirements. Such steps include notifying FEMA or its designee of the identity of the new servicer.<sup>56</sup>

### **ENFORCEMENT: CIVIL MONETARY PENALTIES**

Under the NFIA, a regulated lender demonstrating a “pattern or practice” of violating any of the following statutory requirements is subject to civil monetary penalties (CMPs): (1) purchasing flood insurance where available; (2) escrowing flood insurance premiums, when required; (3) force placing flood insurance after providing the requisite notice to the borrower; (4) providing notice of special flood hazards and the availability of federal disaster relief assistance; and (5) providing notice of the identity of the loan’s servicer and any change of that servicer to the regulatory entity.<sup>57</sup>

The NFIA does not define “pattern or practice.” In determining whether a financial institution has engaged in a pattern or practice of flood insurance violations, the following factors may be considered: the duration of noncompliance; significance of the number of violations; prior citations for noncompliance with flood insurance regulations; strength of the institution’s audit process at identifying and addressing flood compliance deficiencies; and the presence of effective flood

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<sup>52</sup> Interagency Flood Q&A 19

<sup>53</sup> Interagency Flood Q&A 21

<sup>54</sup> Interagency Flood Q&A 22

<sup>55</sup> Interagency Flood Q&A 22

<sup>56</sup> Interagency Flood Q&A 44. The issue of third-party servicing compliance obligations is also discussed in Interagency Flood Q&As 45-50.

<sup>57</sup> 42 U.S.C. 4012a(f). See also Interagency Flood Q&A 81.

insurance compliance policies and procedures and/or an employee training program. While “[i]solated, unrelated, or accidental occurrences” will not be deemed a pattern or practice, “repeated, intentional, regular, usual, deliberate, or institutionalized practices will almost always constitute a pattern or practice.”<sup>58</sup>

Banking regulators assess CMPs for violations when required by the statute. In addition to imposing a substantial financial penalty, CMPs can cause reputational damage to financial institutions because the CMP

orders are often reported by local media outlets and are tracked on websites.<sup>59</sup>

### CONCLUSION

Congress enacted the NFIA to reduce the costly burden of floods. In recent years, major flooding has caused devastating property losses, making the NFIA and its amendments even more crucial. It is important that financial institutions have a strong flood insurance compliance program. Specific issues and questions about consumer compliance matters should be raised with your primary regulator. ©

<sup>58</sup> Interagency Flood Q&A 82

<sup>59</sup> See, e.g., *Flood Penalties Watch*, available at <http://bit.ly/flood-cmp>.



# OUTLOOK

## LIVE WEBINARS

The Federal Reserve System regularly conducts *Outlook Live* webinars on consumer compliance topics. All webinars are free of charge. The table below lists the 2011 archived presentations. You can view the webinars and download the presentation slides on the *Outlook Live* archive page: <http://bit.ly/Outlook-webinars>.

Date	Webinar	Description
12/15/11	<b>Consumer Compliance Hot Topics</b>	Discussion of significant 2011 compliance changes and a preview of changes expected in 2012.
11/02/11	<b>Fair Lending Issues and Hot Topics</b>	Discussion of several fair lending topics, including the activities of the Interagency Non-Discrimination Working Group of the Financial Fraud Enforcement Task Force.
10/04/11	<b>Real Estate Owned (REO) Disposition Risks and CRA Opportunities</b>	Discussion of financial, reputational, legal, and compliance risks associated with REO properties and potential CRA opportunities from alternative uses of these properties.
05/26/11	<b>Proposed Ability to Repay Standards for Mortgage Loans</b>	Discussion of the proposed final rule under Regulation Z to require creditors to determine a consumer's ability to repay a mortgage loan before making the loan.
04/06/11	<b>CRA and HUD Neighborhood Stabilization Program</b>	Discussion of new CRA opportunities under the Neighborhood Stabilization Program.
03/17/11	<b>Loan Originator Compensation</b>	Discussion of new regulatory requirements for loan originator compensation.
02/16/11	<b>Risk-Based Pricing (RBP) Notices</b>	Discussion of the new regulatory requirements for the RBP notices.

# REGULATORY CALENDAR\*

EFFECTIVE DATE	STATUTE/ IMPLEMENTING REGULATION	REGULATORY CHANGE	OUTLOOK ARTICLE/ WEBINAR
*		CFPB solicits comments on streamlining regulations	
*	24 CFR Part 100	HUD proposal for uniform standards for identifying disparate impact discrimination under the FHA	
1/1/2012	Reg. Z	Annual adjustment of fee-based trigger for HOEPA loans	
1/1/2012	Regs. Z and M	Annual adjustment of dollar threshold for exempt consumer credit and lease transactions	
10/17/2011	Reg. H	Revised Interagency Q&A regarding flood insurance and new proposed questions on forced placement	Q4 2011
10/1/2011	Reg. II	Final rule on debit card interchange fees and network exclusivity arrangements	
10/1/2011	Reg. Z	Clarification of Credit CARD Act regulations	
8/15/2011	Reg. V	Final rule to implement Dodd-Frank Act credit score disclosure requirement for risk-based pricing notices	Q3 2011
8/15/2011	Reg. B	Amended model ECOA/FCRA adverse action notice that includes Dodd-Frank Act credit score disclosure requirements	
7/29/2011	SAFE Act	Deadline for mortgage loan originators employed by regulated institutions to register with SAFE Act registry	
7/22/2011	Reg. D	CFPB interim final rule from under AMTPA to authorize state-chartered or licensed creditors to continue making mortgage transactions under parity with federal law	
7/21/2011	Regs. Z and M	Increase in transaction coverage for Regulations Z and M from \$25,000 to \$50,000	Q3 2011
7/21/2011	Reg. II	List of institutions subject to, and exempt from, debit card interchange fee standards	
7/21/2011	Reg. Q	Final rule repealing Reg. Q (prohibiting interest on demand deposits for member banks of the Federal Reserve System)	
*	Dodd-Frank Act	CFPB seeks comment on rulemaking defining larger participants in certain consumer financial products and services markets	
*	Reg. RR	Proposal to implement Dodd-Frank Act provision defining "qualified residential mortgage" for purposes of securitization risk retention	
*	Reg. Z	Proposal to implement Dodd-Frank Act provisions establishing ability-to-repay requirements for mortgages and limitations on prepayment penalties	W
*	Reg. E	Proposal to implement Dodd-Frank Act provision creating new consumer protections for remittance transfers	
*	Reg. CC	Proposal to amend Regulation CC regarding collection of checks and availability of funds	
*	Reg. B	Final rule clarifying that motor vehicle dealers do not have to collect and report ECOA data until implementing regulations are issued	
*	CRA	New list of distressed or underserved nonmetropolitan middle-income geographies	
5/1/2011	31 CFR Part 212	Interim final rule for garnishment restrictions of federal benefit payments paid by direct deposit	
4/1/2011	Reg. Z	Final rule establishing escrow requirements for HPML jumbo mortgages	
4/1/2011	Reg. Z	Final rule establishing restrictions on loan steering and loan originator compensation	W
4/1/2011	Reg. Z	Interim final rule for appraisal independence requirements	Q3 2011
*	Reg. Z	Proposal to lengthen escrow periods for HPMLs and exempt certain creditors from escrow requirements	

\*Rulemaking proposals generally do not have an effective date, except for some of the proposed Dodd-Frank Act implementing regulations because Congress specified the effective date in the legislation. Agency requests for information also do not have effective dates.

**ADDRESS SERVICE REQUESTED**

## CALENDAR OF EVENTS

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|-----------------------------|--|
| <b>February 6-10, 2012</b>  | National Fair Lending Initiative Training<br>National Community Reinvestment Coalition<br>Las Vegas, NV      |
| <b>February 15-16, 2012</b> | HUD's Loss Mitigation Program Training<br>HUD<br>Oklahoma City, OK   |
| <b>March 19-21, 2012</b>    | CBA Live 2012<br>Consumer Bankers Association<br>Austin, TX  |
| <b>March 25-28, 2012</b>    | 2012 National Interagency Community Reinvestment<br>FDIC, FRB SF, OCC, and Treasury CDFI Fund<br>Seattle, WA |