



May 20, 2008

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
Docket ID OCC-2008-0002

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No OP-1311

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-ZA00

Regulation Comments, Chief Counsel's
Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
ID OTS-2008-0001

Gary K. Van Meter, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

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

Dear Sir or Madam:

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to respond to proposed changes and additions to the Interagency Questions and Answers Guide on Flood Insurance. We would like to comment on several aspects of the proposal that MBA believes to be problematic and require adjustment by the regulators. Specifically we suggest:

- revising the coverage requirements for unit owners where condominium association coverage is insufficient;
- clarifying forced placed coverage on second mortgage loans;
- eliminating the prohibition on gap policies; and

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

- eliminating the requirement that lenders verify the accuracy of flood zones for insurance agents.

Questions 24 and 26 Dwelling Form Coverage for Condominiums

The proposed answer to question 24 changes existing guidance with regard to the proper amount of insurance coverage for a condominium association and individual unit owner. In particular, the proposal provides that the appropriate amount of Residential Condominium Building Association Policy (RCBAP) coverage is 100 percent, rather than the existing standard of 80 percent, of the insurable value (replacement) cost or an amount equal to \$250,000 multiplied by the number of units, whichever is less. If the condominium association fails to have sufficient RCBAP coverage, the lender would be required to ensure that the unit owner obtains insurance that equals the lesser of the maximum limit available for a residential condominium unit (currently, \$250,000) or the insurable value of the unit (the replacement value of the building divided by the number of units), whichever is less. In effect, the borrower would be required to obtain an individual Dwelling Form policy for the difference between the RCBAP's coverage allocated to the individual unit and the mandatory flood insurance requirement for that unit. While this calculation makes sense in theory, the reality is that the borrower will be required to purchase a flood Dwelling Form policy that may not provide any real coverage for the borrower due to the limitations on the assessment coverage in the Dwelling Form for coinsurance penalties and deductibles.

Consequently, the lender will be compliant, but it will require the borrower to purchase a supplemental dwelling policy that provides little coverage for a very real assessment exposure. Unfortunately, the proposed Q&A dismisses this issue and merely states "It is incumbent on the lender to understand these limitations." There is little comfort to a lender that has required supplemental coverage or to a borrower, who has purchased such coverage, when the policy will not pay a claim to cover any co-insurance assessment. If the Agencies are recommending this option to lenders, MBA strongly recommends that the Agencies work with the Federal Emergency Management Agency (FEMA) to remove the assessment limitations in the Dwelling Form policy, thereby allowing borrowers to purchase individual policies that have value and will provide coverage in the event of an assessment due to a coinsurance penalty or deductible.

Questions 32 and 56 Second Mortgage Loans and Forced Placement of Flood Insurance

Question 32 provides information as to the amount of flood insurance that must be required at loan inception when a lender makes a second mortgage on a property in the Special Flood Hazard Area. The guidance states further that the amount of flood insurance at loan inception must be equal to the lesser of: a) the maximum coverage available under the Act, b) the insurable value of the building or mobile home, or c) the combined total outstanding principal balance of the first and second loans (also known as "total indebtedness").

We are unclear, however, on the correct amount of coverage for a lender in the junior position to force place if the borrower fails to maintain flood insurance coverage after loan closing.

We understand and agree that a lender in the junior position, utilizing the Mortgage Portfolio Protection Program (MPPP) for its forced placed program, needs to coordinate with the lender

in the first position to protect its interest because only one policy can be written on the property and the MPPP pays claims in order of lien priority.

Because of the limitations in the MPPP, and the difficulties of coordinating and monitoring the forced placed coverage, many lenders have elected to utilize a private forced placed flood insurance program. Under these programs, the junior lender is the named insured and the borrower an additional insured. As a result, the private forced placed policy will pay the junior lien-holder the amount of its claim even when the first lien-holder is underinsured.

Because all regulated lenders have the same statutory obligation, the lender in the senior position is obligated to force place flood insurance for the amount of its loan. If the junior lender force places coverage in the amount of its line or loan under a private forced placed program, the total indebtedness is insured, the interests of all parties are covered, and each lender is in control of its own forced placed coverage.

Please confirm in the final guidance that junior lenders that utilize acceptable private forced placed insurance programs, that only cover the interests of the junior lender and the borrower,² and are written to provide coverage in the amount of the outstanding balance on the junior line or loan are in compliance with the regulation.

Question 57

Treatment of Gap and Blanket Insurance Policies

The Agencies are proposing to add a new question and answer on the appropriateness of gap or blanket insurance policies. Specifically, the Agencies are proposing that gap or blanket insurance is not an adequate substitute for National Flood Insurance Program (NFIP) insurance. The reasoning for such exclusion is that gap or blanket policies typically protect only the lender's, not the borrower's interest, and cannot be transferred when a loan is sold. The question and answer would acknowledge, however, that in limited circumstances, a gap or blanket policy may satisfy flood insurance obligations in instances where NFIP and private insurance for the borrower are otherwise unavailable.

MBA believes this general exclusion might be prompted by some confusion in terminology between "gap" and "blanket" insurance that fails to recognize the nature and operation of gap insurance. "Gap" insurance, also known within the industry as "deficiency coverage," is purchased by lenders when borrowers have flood insurance but fail to have a sufficient amount of coverage as required by the mandatory flood insurance purchase requirement or investor requirements. Instead of force placing an insurance policy for the entire amount of the necessary coverage, the lender typically purchases a gap policy for the deficiency. This practice recognizes the borrower's existing coverage and avoids duplicating coverage or premium charges to the borrower. Traditional flood gap insurance is written in private force placed programs, on a particular property and is not written as blanket coverage. In many cases, these gap policies provide dual interests (both individual and lender) coverage³ and they are designed to apply in excess of a basic (but deficient) NFIP policy.

We urge the agencies to make a distinction between "gap" and "blanket" flood insurance and continue to permit the purchase of "gap" insurance. Failure to do so would negatively impact borrowers and would increase borrower costs when underinsured.

² Connecticut state law prohibits dual coverage on forced placed policies. See Connecticut Requirements Form RD 7 88.

³ Id.

Questions 64 and 65 Verification of Flood Zone

The Agencies are proposing two new questions concerning issues where there is a discrepancy between the flood hazard zone designation on the lender's flood hazard determination form and the flood hazard zone designation on the flood insurance policy. Proposed new question 64 would address how lenders should respond when confronted with a discrepancy between the two. Proposed new question 65 indicates that regulators will consider a pattern of unexplained discrepancies as a violation of National Flood Insurance Reform Act of 1994 (NFIRA).

MBA opposes this requirement because it transfers FEMA's enforcement obligations to oversee its Write-Your-Own ("WYO") carriers and insurance agents onto the lending community, which is not equipped to serve in this role. Moreover, this creates a significant regulatory and paperwork burden on borrowers, lenders, insurance agents and WYO carriers without a corresponding benefit or protection to the borrower. The proposal also creates liability for errors. FEMA, by its own admission, is unable to produce any statistics that indicate that there are significant numbers of errors in rating flood insurance policies caused by utilization of an incorrect flood zone. Finally, the proposal is excessive because the NFIP policy will provide the coverage amount indicated on the declaration page of the policy even if the flood zone is incorrect. We more fully address these issues below.

A. Lenders as Enforcers

The Agencies propose to require that lenders verify the flood zones on their determinations match those on the policies. This suggests there may be a widespread insurance agency practice of under-insuring residential properties and that such actions have created a material safety and soundness risk for the lending community, the NFIP, or harm to the borrowing community. No facts were presented to support the need for this new policy. For these and other reasons, we respectfully oppose this policy. Lenders are not in the position to enforce the insurer's obligation to write insurance policies correctly. If there is widespread failure on the part of insurance agents to properly insure properties, FEMA, or its WYO companies, should audit and sanction such agents. Lenders should not be in the position of performing this function, with the added risk of sanctions against them for the insurer's mistakes or misdeeds.

The proposal implies that if lenders oversee flood zone ratings, insurers will stop incorrectly rating and insuring these properties. While the lender can certainly put pressure on insurers to change their behavior by rejecting a flood insurance policy, the result will harm the borrower. A rejection of a policy in most cases means the closing will have to be postponed or cancelled, which in turn, may result in the borrower losing his/her rate lock and possibly a good faith deposit while the lender and insurer resolve the issue or seek a Letter of Determination Review (LODR) from FEMA. This is not a positive result. The proposal also assumes that lenders have sufficient information to determine or validate whether a property is subject to an administrative grandfathering rule that would explain a discrepancy. Lenders do not have this information. FEMA, the insurance agent and WYO carriers have this information and are, therefore, in the best position to determine the correct flood zone for policy rating and premium. In addition, lenders do not have leverage over insurers to enforce the flood zone once the loan is closed. Given that borrowers often change insurance agents or WYO carriers over the life of the loan, the only option available to a lender for zone or other rating issues on a flood policy provided post closing would be to force place flood coverage if the borrower refused to cooperate in the

event of a flood zone dispute. Force placing flood insurance for a zone dispute should not be required given that the NFIP policy provides coverage for the amount indicated on the policy declaration page even if the flood zone is incorrect.

B. Burden on Financial Institutions

Question 64 discusses the legitimate reasons why flood zone discrepancies may exist, such as a property with an administrative grandfathering exception. If there is a discrepancy, the answer suggests that the lender should determine if there is a legitimate reason for the discrepancy. In December, the Federal Deposit Insurance Corporation (FDIC) issued guidance stating that the lender should resolve the discrepancy.⁴ Because of FEMA's rating rules related to grandfathering, lenders are not in a position to know which flood zone should be utilized for rating purposes. Additionally, there is no benefit to the lender to verify the accuracy of policy rating, nor any risk to the collateral. Moreover, FEMA is unable to produce statistics that indicate there are significant numbers of errors in rating flood insurance policies caused by utilization of an incorrect flood zone. As a result, we oppose placing the burden of verification and reconciliation on the lending community. The proposal imposes a significant obligation and cost on lenders to manage insurance agents and WYO carrier oversight.

We believe that one of two results are likely to occur from this new guidance, neither of which is ideal, as the guidance would either impose additional operational burdens on financial institutions or shift liability to these entities. We explain our concerns in greater detail below:

- 1) **The WYO carrier continues to obtain its own flood determination in order to write the policy.** In this case, lenders will have to enhance their systems or create a manual process to begin collecting and comparing flood zones they have determined with the flood zone the insurer includes on the flood insurance policy. Servicing systems used by the industry are not currently programmed to perform these functions. These system enhancements will take considerable time to create, test, and implement and the cost of these system upgrades will be borne by lenders. Smaller lenders, lacking automated systems, will need to train additional personnel in the nuances of flood insurance policy rating. The lenders, having a direct relationship only with the borrower, will contact the borrower, who will contact the insurance agent, who will then contact the WYO carrier. Thus, the WYO carriers will need to employ additional staff to field inquiries from lenders and agents about zone discrepancies.
- 2) **The WYO carrier relies solely on the lender's determination and no longer obtains its own.** The proposed guidance applies solely to regulated financial institutions. There is no obligation for the insurance agent or WYO carrier to continue to obtain a flood determination to correctly rate the flood insurance policy if this new guidance effectively shifts the entire responsibility of flood determination onto the lending community. We are concerned that insurance agents will begin to rely solely on the lender's determination. This raises concerns that the flood determination completed by the lender could be construed to be risk management advice for borrowers and impose subsequent civil liability for inaccurate determinations on lenders rather than rightfully imposing such obligations and liability with the insurance agent. Specifically, we are concerned that a borrower may be able to bring suit against the lender for excessive

⁴ FDIC, Financial Institution Letter, FIL-114-2007, (Issued December 21, 2007).

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premiums paid if grandfathering rules could have applied. The cost of defending these claims and the business reputation risk are of primary concern.

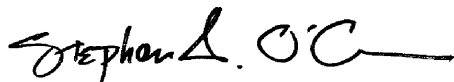
MBA recommends that FEMA enforce the requirement that insurers and agents provide appropriate NFIP coverage, including obtaining the correct flood determination in order to issue coverage in the correct flood zone. Lenders should not be responsible for overseeing and enforcing the quality of the work of WYO carriers and insurance agents. Moreover, the shifting of responsibility onto the lender to evaluate and enforce an underwriting criterion crosses over into the business of insurance, for which national banks and thrifts are specifically precluded from performing.

C. Current Remedy is Sufficient

Given that properties may be subject to administrative grandfathered rating rules, Letters of Map Revision (LOMRs) and Letters of Map Amendment (LOMAs), discrepancies in the apparent flood zone will occur. Moreover, flood maps are not always clear, which results in discrepancies in flood determinations between reputable companies. FEMA recognized that rating errors could occur and created protections for policy holders when the Standard Flood Insurance Policy was drafted. The current flood insurance policy provides that NFIP will pay a claim up to the amount of coverage shown on the declaration page, even when the borrower under-paid premiums due to a rating error in coverage. The borrower or mortgagee is not penalized in the amount of its claim for flood damage, however, the policy will be correctly rated prospectively.⁵ This is a fair solution and is not overly burdensome to the borrower, lender, agent or WYO carrier.

Thank you for this opportunity to comment on the proposed question and answer guidance on flood insurance. We appreciate your consideration of our comments. Please contact Vicki Vidal at (202) 557-2861 or VVidal@mortgagebankers.org if you would like to discuss our recommendations in further detail.

Most sincerely,



Stephen A. O'Connor
Senior Vice President, Government Affairs

⁵ 42 U.S.C. 4015(f).