



# ZC STERLING

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Date: September 21, 2009

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From: Wade Hardcastle ([wade.hardcastle@zcsterling.com](mailto:wade.hardcastle@zcsterling.com))  
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RE: Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance:  
OCC Docket ID - OCC-2009-0014  
FRB Docket No. R-1311  
FDIC RIN No. 3064-ZA00  
OTS Docket ID - OTS-2009-0005  
FCA RIN No. 3052-AC46  
NCUA RIN No. 3133-AD41

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The following comments are submitted by ZC Sterling Corporation ("ZCS") on our behalf and behalf of our lender clients. ZCS provides automated tracking of flood insurance for mortgage lenders – originators and servicers on their own behalf, servicers on behalf of other investors, servicers on behalf of the GSEs, and servicers of government loans (FHA/VA). ZCS provides force-placed flood insurance through private insurance programs. ZCS has provided loan tracking services and lender placed insurance for over 30 years and has provided force-placed flood insurance under the NFIP MPPP and private insurers for over 15 years. The opinions expressed are those of ZCS and do not necessarily represent the opinions of all clients, although these issues have been discussed with our clients and they have requested that we submit comments regarding Question #62.

**Question #62. Does a lender or its servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period?**

We respectfully disagree with the proposed response to Question 62. The proposed response indicates that "there is no authority under the Act and Regulation to charge a borrower for a force-placed flood insurance policy until the 45-day notice period has expired" and "therefore, lenders may not charge borrowers for coverage during the 45-day notice period."

We agree the Act and Regulation require the lender or servicer to provide 45-day notice to the borrower before they obtain force-placed flood insurance. We also agree the lender is required to obtain insurance upon expiration of the 45-day notice period and may charge the cost of this insurance to the borrower if the borrower has not provided flood insurance. We understand that force-placed flood insurance through the NFIP MPPP ("Mortgage Portfolio Protection Program") is not available until the 45-day notice has expired. We know that flood insurance is available for the

benefit of the borrower and lender through private insurance during the 45-day notice period. ZCS is one of the several companies through which this coverage is available.

Our review of the Act and Regulation reveal no portion that specifically prohibits a lender from obtaining force-placed flood insurance and charging the cost of this insurance to the borrower for the 45-day notice period. We believe the availability of coverage for the borrower and lender during the 45-day notice period and the lender's right to charge the cost to the borrower is not prohibited by the Act and Regulation and is in the best interest of the borrower, the lender, and the flood insurance program for the reasons indicated below.

**1. Obtaining force-placed flood insurance for the 45-day lapse period and charging such coverage to the borrower is consistent with the intent of the Act and Regulations.**

The National Flood Insurance Program was created to provide property owners with reliable flood insurance coverage, strengthen the mortgage market by ensuring that secured properties could be protected against flood loss, and reducing public liability for costs associated with catastrophic flood loss. The Act and Regulation require federally regulated lenders who "make, increase, extend, or renew" a "designated loan" (a loan secured by a property located in a Special Flood Hazard Area and within a participating community) to ensure that flood insurance is obtained and maintained on the property throughout the term of the loan.

Mortgage Agreements for designated loans require borrowers to obtain and maintain flood insurance. These agreements permit the lender to obtain flood insurance on behalf of and at the expense of the borrower if the borrower fails to maintain insurance. Federal flood requirements state that *"If at any time during the term of a covered loan, the lender or servicer determines that the building securing the loan is not covered by flood insurance, or is covered by such insurance in an amount less than that required by law, the lender or servicer must first notify the borrower of the need to carry adequate flood insurance coverage." "The notice must state that the borrower should, at the borrower's expense, obtain flood insurance that is not less than the amount required under the law. If the borrower fails to purchase such flood insurance within 45 days after such notification, the lender or servicer shall purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees incurred by the lender or servicer."*

The Government Sponsored Enterprises ("GSEs"), Freddie Mac and Fannie Mae, support the purpose of the Act and Regulations by requiring loans originated or serviced on their behalf to be insured against flood loss throughout the term of the loan.

*"If the SFHDF identifies the insurable improvements on the Mortgaged Premises as located in an area that has been identified as a SFHA designated as Zone "A" or "V" on a flood map (Flood Hazard Boundary Map or Flood Insurance Rate Map) of FEMA, the Seller/Servicer must ensure that flood insurance is obtained and maintained on such improvements **for the term of the Mortgage.**"* (Freddie Mac Single Family Seller/Servicer Guide, emphasis added)

*"We require that any mortgage secured by a property located in a Special Flood Hazard Area have adequate flood insurance **when the mortgage is originated and that the coverage be maintained for as long as the mortgage is outstanding or as long as the property is in a Special Flood Hazard Area.**"* (2006 Fannie Mae Servicing Guide, emphasis added)

The Act and Regulation place the primary burden on the borrower to obtain and maintain required flood insurance. Enforcement authority is provided to the lender and includes responsibility to provide notice to the borrower and purchase flood insurance if the borrower fails to provide.

The requirements of the Act and Regulation, the GSE requirements, and the mortgage agreement requirements for flood insurance support the intention of the flood insurance program that properties securing designated loans be insured at all times. The ability of the lender to obtain flood insurance for the 45-day lapse created by the notice period is consistent with the intent that adequate insurance coverage be in force for designated loans at all times. The lender must provide the required 45-day notice and may not purchase the coverage until the end of the 45-day notice period, but the lender should be permitted to obtain coverage for the 45-day lapse in coverage protecting the interest of the borrower and lender and should be permitted to charge the cost to the borrower whose mortgage agreement requires that flood insurance be maintained.

**2. Obtaining force-placed flood insurance for the 45-day lapse period and charging such coverage to the borrower is not specifically prohibited by the Act and Regulations.**

The Act and Regulation require the lender to provide 45-day notice to the borrower and purchase flood insurance coverage at the expiration of such notice, but the Act and Regulation does not prohibit the lender from purchasing flood insurance for the 45-day lapse and charging the cost to the borrower. The Agencies argue that the Act and Regulation contain no authority to charge the borrower and therefore “lenders may not charge borrowers for coverage during the 45-day notice period.” We contend that in the absence of a specific prohibition against charging the borrower for force-placed coverage during the 45-day notice period, the lender has the right to do so.

The Act and Regulations contain a number of situations where flood insurance is not available. These include situations where the value of the property exceeds \$250,000, properties located in CBRA zones, and properties located in non participating communities. In each of these situations the NFIP is designed to not provide coverage, but the Act and Regulations permit the lender to require such coverage and the Mandatory Purchase of Flood Insurance Guidelines clearly encourage the lender to consider private insurance for these exposures. Likewise, the NFIP does not provide an ability to obtain coverage during the 45-day notice period, but the Act and Regulation does not prohibit a lender from obtaining this coverage and charging the borrower for the cost if this coverage is available. Private insurance makes this coverage available and is not prohibited from doing so by the Act or Regulation.

The Mandatory Purchase of Flood Insurance Guidelines specifically outlines requirements for flood insurance provided by private insurance. None of these guidelines specify that the private insurer cannot provide coverage for those situations where coverage is not provided by the NFIP. The requirements specifically indicate that private flood insurance coverage must be at least as broad as coverage provided by the NFIP. In the absence of specific prohibitions within the Act and Regulation we do not believe that the Act and Regulation either prohibit or were intended to prohibit a lender from obtaining flood insurance for the 45-day notice period and charging the cost of the premium to the borrower.

The Agencies may argue that the 45-day notice period does not actually create a lapse in coverage, at least as it applies to the mortgagee. We understand that upon expiration of the flood insurance policy the borrower has 30-days to pay the premium, at which time the policy is reinstated without lapse in coverage. If the premium is not paid by the borrower, the mortgagee is extended coverage in the event of a loss by paying the premium and submitting a claim under the policy for the interest of the mortgagee only. Lenders appreciate this extension of coverage, but believe that it may create additional difficulties for the borrower.

First, the borrower is afforded no coverage during this 45-day notice period. Additionally, although the lender is protected for the first 30-days, the lender has no protection for the remaining 15 days. Lenders believe that both the absence of coverage for the borrower and the absence of coverage for the lender for the remaining 15 days present an unacceptable exposure.

Lenders are also concerned with the subrogation provisions of the NFIP policy if a claim is paid under the mortgagee extension during the 30 days following expiration. Under these circumstances, the rights of the mortgagee are subrogated to the NFIP insurer and the insured borrower is now indebted to the insurer for the amount of loss that is paid. In this instance, the borrower not only has no insurance coverage because they have not renewed their policy, but may be saddled with additional expenses far beyond any premium that would be charged for the 45-day notice period. This consideration is especially relevant during difficult economic times when a greater number of borrowers may consider not renewing their flood insurance policy due to economic hardship.

If no other alternative existed, the extension of coverage for the mortgagee might be acceptable. Force-placed insurance coverage through private insurers has been used for many years by lenders to provide full coverage for the borrower and lender during the 45-day notice period. Removing this protection in the absence of a specific prohibition within the Act and Regulation removes security for the borrower and lender, as well as an effective enforcement tool for lenders. Coverage is provided only for that portion of the 45-day notice period that is not otherwise provided by borrower-obtained coverage.

**3. Obtaining force-placed flood insurance for the 45-day lapse period and charging such coverage to the borrower is consistent with safety and soundness intentions of the Act and Regulations.**

The Act and Regulation promotes two responsibilities for the lender in regard to flood insurance – compliance with the Act and Regulation and “safety and soundness” considerations. The Act and Regulation require that lenders provide 45-day notice to the borrower and obtain flood insurance at the end of the notice period if the borrower fails to provide insurance. The Act and Regulation does not prohibit obtaining coverage for the 45-day notice period or charging the coverage to the borrower.

The Act and Regulation encourages the lender to take into consideration the safety and soundness of their loan portfolio associated with flood insurance. Lenders are “audited” by the Agencies to ensure that both compliance and safety and soundness are considered in the administration of the lender’s portfolio. The Act encourages lenders to determine if adequate flood insurance is maintained by the borrower and permits the lender to require higher limits than those available through the NFIP. The Act permits lenders to require flood coverage for properties that are located in non required flood zones. Lenders are encouraged to administer flood insurance requirements in a similar manner to how they administer requirements for other property insurance. All of these encouragements are based on the Act and Regulations concern not only with compliance, but also with the safety and soundness of the loan portfolio.

Lenders believe that any lapse in flood insurance coverage for designated loans presents both a compliance and safety and soundness challenge. Compliance can be achieved by providing the 45-day notice and obtaining coverage at the end of the notice period. Lenders do not believe that the safety and soundness considerations of their portfolio can be achieved by allowing the borrower and/or lender to not be fully protected during the 45-day notice period. Lenders believe that by obtaining coverage for the lapse created by the notice period and charging this coverage to the borrower they ensure the ongoing protection against flood loss for their secured properties on designated loans. Without this ability, the borrower is provided no protection and may actually become more indebted under the subrogation conditions of the NFIP policy. The lender is forced to accept at least 15 days with no flood insurance. This presents an unacceptable exposure to lenders that can easily be addressed through the availability of private force-placed flood insurance for the 45-day notice period and charging the cost of such insurance to the borrower.

**4. Obtaining force-placed flood insurance for the 45-day lapse period and charging such coverage to the borrower provides protection not otherwise afforded by the Act and Regulations.**

Lenders understand that the NFIP program as determined by the Act and Regulation does not provide coverage, other than under the mortgagee clause, for the 45-day notice period. Lenders are required by the Mandatory Purchase of Flood Insurance Guidelines to enforce the flood regulations whenever they “make, increase, extend, or renew” a designated loan. The 30-day waiting period is waived whenever the purchase of flood insurance is made in compliance with the lender requirement. The 30-day waiting period does not apply to the expiration of a flood insurance policy but insurance is not available under the program until the expiration of the 45-day notice period.

Private insurance has recognized the need for such coverage as lenders have indicated that absence of coverage during the 45-day notice period presents an unacceptable exposure. Private flood insurance products were created specifically to address this need and are made available to lenders only when the borrower has failed to obtain or maintain insurance. Private flood insurance is generally provided with no waiting period and intended to cover the interest of the borrower and lender whenever a lapse in the NFIP policy occurs. Lenders desire that borrowers obtain their own flood insurance, but if the borrower fails to renew an expired flood insurance policy the lender must have an alternative to protect its interest and the interest of the borrower. For the lender, the most important aspect of private flood insurance during the 45-day notice period is preventing uninsured flood loss. Protections afforded under the private insurance flood policy for the 45-day notice period ensure that both the borrower and lender are protected. Because the NFIP does not make this coverage available, the private flood insurance market has provided products which prevent the borrower and the lender from experiencing uninsured loss during some or all of the 45-day notice period.

**5. Obtaining force-placed flood insurance for the 45-day lapse period and charging such coverage to the borrower holds the insured responsible for maintaining coverage under the Act and Regulations.**

The intention of the Act and Regulation is to provide the opportunity to borrowers to obtain required flood insurance coverage and provide authority to the lender to enforce these requirements. We do not believe the intention of the Act and Regulation is to provide a "grace" period to borrowers who fail to renew their flood insurance coverage. Most borrowers respond positively to the 45-day notice and renew their flood insurance coverage. For those borrowers who do not, prohibiting flood insurance during the 45-day notice period removes the lender's ability to enforce their mortgage agreement, which requires maintenance of flood insurance throughout the term of the loan, as well as enforcement of GSE guidelines, if applicable. Charging the borrower the cost of obtaining such insurance holds the borrower accountable for the commitment required under the Act and Regulation, as well as the mortgage agreement.

Lenders are concerned that borrowers may recognize the inability of lenders to enforce continuous coverage and rely upon the 45-day notice as a "grace period" for renewing their flood insurance coverage. We do not believe this is the intent of the Act and Regulation. We are also concerned that the proposed response to Question 62 will in effect "codify" this "grace period" and will make it more difficult for lenders to enforce the requirement that flood insurance be maintained.

We also have concerns about the apparent disparate treatment that is created if lenders are not able to enforce flood insurance requirements for continuous coverage upon all borrowers. Prohibiting the lender from obtaining flood insurance for the 45-day lapse period and charging the premium to the borrower may create two classes of borrowers: one which complies with the requirement to maintain flood insurance throughout the term of the loan and the second, borrowers for which the lender cannot enforce continuous coverage. We do not believe this is either the intention of the Act and Regulation or the intention of the Agencies, although the proposed response to Question #62 may in effect create this situation.

The ability of the lender to enforce continuous flood coverage by obtaining and charging the borrower for coverage during the 45-day notice period provides both fair and equal treatment to all borrowers. Borrowers have committed as part of their mortgage agreement to obtain and maintain flood insurance during the term of their loan. Prohibiting lenders from enforcing the continuous insurance requirement during the 45-day notice period removes a valuable tool for enforcement.

We understand there may be situations where the lender should not obtain flood insurance during the 45-day notice period and charging this coverage to the borrower. An example may be a remapping situation where the borrower for a secured property is newly required to obtain flood insurance. In this situation, the lender should provide adequate time for the borrower to obtain coverage before obtaining force-placed coverage and charging it to the borrower. This situation is different from the borrower who previously was required to obtain flood insurance coverage but has failed to renew the policy. Borrowers who fail to renew their required flood insurance are well aware of the requirement and are appropriately protected by force-placed flood insurance during the 45-day notice period, as well as appropriately charged for the insurance coverage.

### **Summation**

Coverage during the 45-day notice period presents a challenge to the Agencies and Lenders. The best alternative is to ensure that lenders have available to them tools to enforce continuous flood insurance coverage. Because coverage is not available under the NFIP for the 45-day notice period, private insurance has made available to lenders a method to protect themselves and their borrowers, to appropriately charge the borrower for required coverage, and fulfill the intent of the Act and Regulation to ensure continuous coverage for flood required loans. In the absence of a specific prohibition within the Act and Regulation and to strengthen the ability of lenders to enforce continuous flood coverage on designated loans, we request that the Agencies revise their proposed response to Question 62 to support the provision of flood insurance coverage for the 45-day notice period and permit the charging of this cost to the borrower.

Please feel free to contact us if you have any questions or we can provide any additional information.