September 21, 2009

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Re: Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance; OCC Docket OCC-2009-0014; FRB Docket No. R-1311; FDIC RIN No. 3064-ZA00; OTS Docket OTS-2009-0005; FCA RIN 3052-AC46; NCUA RIN 3133-AD41

Dear Sir or Madam:

The Mortgage Bankers Association (MBA)[1] and the Housing Policy Council (HPC)[2] appreciate the opportunity to comment on the Interagency Questions and Answers (Q&As) relating to flood insurance published July 21, 2009. In sum, our trade associations would like to offer our views on the proposed new Questions and Answers open for public comment. We also would like to express grave concern with the short implementation

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 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.

[2] The Housing Policy Council (HPC) is made up of twenty-six companies that are among the nation's leaders in mortgage finance. Member companies originate sixty-five percent of the mortgages for American home buyers. Member companies participate in the Council through the senior mortgage executive in their company. HPC is part of the Financial Services Roundtable (the Roundtable), a trade association for 100 of the nation's largest banking, securities and insurance companies. Roundtable member companies provide fuel for America's economic engine, accounting directly for $85.2 trillion in managed assets, $980 billion in revenue, and 2.3 million jobs.

period and respectfully ask the agencies to delay implementation until April 1, 2010. Below are our specific comments.

Extension of Compliance Date

MBA and HPC members express grave concern with the September 21, 2009, implementation date for the Question and Answers rules. Sixty days is insufficient time to analyze, interpret and implement based upon clarifications of requirements that were previously unclear and based upon the new requirements announced. Significant enhancements to origination and servicing systems and overhauls to operational procedures are required. The most significant changes and clarifications were made to requirements for condominium coverage, junior lien coverage, and resolving flood zone discrepancies. These new changes require mortgage companies to interpret the requirements, build business rules to accommodate the changes, work with technology staff to capture new information, beta test the system changes, and train staff. As you are aware, the vast majority of lenders use third party vendors who specialize in hazard and flood insurance management and provide force-placed coverage. These third parties are critical to the process and must also implement each mortgage company's business rules. This process is complex and time consuming.

Given the level of existing and substantial competing obligations on mortgage company staff and system programmers as well as the complexity of the changes, a 60-day window for implementation is not reasonable or feasible. ***MBA and HPC urgently request the agencies to delay the compliance date of the Questions and Answers until April 1, 2010. This delay would allow lenders to follow previous interpretations and begin implementing the new requirements on loans made, increased, extended or renewed after March 31, 2010.***

The additional time to implement the requirements is particularly important because of the myriad of other new regulatory obligations imposed on lenders and servicers. This year is a particularly difficult year given the other regulatory and business requirements imposed on our members. Servicers are under extreme pressure to comply with Making Home Affordable, the Home Affordable Modification Program, and other regulatory requests for loss mitigation information. These programs continue to absorb an enormous amount of technology, business, regulatory compliance, and legal resources. Mortgage companies are also inundated with other regulatory compliance requirements, including HOEPA, which has an effective date of October 1, 2009; RESPA, which has an effective date of January 1, 2010; New RMBS investor RESTART disclosure and reporting packages, to be implemented by February 1, 2010 and November 1, 2009, respectively; compliance with the Helping Families Save Their Homes Act of 2009 (S.896) section 404, transfer of mortgage notifications and Title VII Protecting Tenants at Foreclosure Act, both of which became effective May 20, 2009 (with no implementation period). Lenders and their vendors are thinly stretched and are constrained by the finite resources to meet all of these obligations. To construct a well tested and compliant system, we strongly ask the agencies to delay the compliance date of the Questions and Answers until April 1, 2010.

Proposed New Questions and Answers

Question & Answer 9: What is the insurable value of a building?

Question & Answer 10: Are there alternative approaches to determining the insurable value of a building?

Methodologies for Determining Replacement Cost Value

These proposed Q&As provide two alternatives for determining replacement cost value (RCV) for non-residential buildings used in ranching, farming, or industrial purposes, which a borrower would either not replace if damaged or would replace with a structure more closely aligned to the function the building is providing at the time of the flood. The two alternatives are:

(1) "functional building cost value," which is the cost to repair or replace a building with commonly used, less costly construction material and methods that are functional equivalent to obsolete, antique or custom construction materials and methods used in the original construction of the building.

(2) "demolition/removal cost value," which is the cost to demolish the remaining structure and remove the debris after a flood.

We greatly appreciate these two alternatives because determining the replacement value of these types of structures has been problematic. We are concerned, however, with limiting these alternatives to only ranching, farming or industrial purposes. We believe these options should be expanded to include any building that is subject to replacement and that utilizing Actual Cash Value as an alternative is also appropriate.

One of the most common compliance challenges is how to handle buildings that serve as collateral for the loan, but which have no or limited useful or actual value and will be demolished. We have often heard complaints from members that flood insurance requirements result in the over-insurance of structures that are purchased as part of a land acquisition for residential or commercial development and which will be demolished. While these purchases often involve farms, ranches or industrial facilities, they can also include other commercial and residential structures.

The interagency guidance has historically provided an exemption to the mandatory purchase rule for structures that are not taken as security for the loan. Unfortunately, this exemption is not viable. Carving out a building from the lien frustrates the lender's ability to foreclose on the loan and clouds title for REO disposition. To provide a viable alternative, we respectfully request that the agencies allow the RCV alternatives to apply to *any* structure that is secured by a loan, where the property is vacant, has no or limited market value (albeit above $5,000), and that will be demolished.

We assume that these two new methodologies are in addition to Actual Cash Value, which is provided for in FEMA's General Property Form for commercial and certain residential buildings (non-owner occupied properties). Actual Cash Value is defined in the form as "The cost to replace an insured item of property at the time of loss, less the value of its physical depreciation."[3] It would be extremely helpful to clarify this point.

Use of Hazard Insurance Policies for Determining Flood RCV

Proposed Q&A 9 provides that when determining replacement cost value for a building, the lender should consider the RCV used in a hazard insurance policy, an appraisal based on a cost-value approach (without consideration for depreciation) or a construction cost calculation. We support allowing these options. However, the preamble includes a parenthetical reference in connection with the hazard insurance RCV implying that lenders must recognize that replacement cost for flood insurance includes the foundation. While we understand that unlike hazard insurance, foundation coverage is included in the flood insurance policy, determining the appropriate amount of coverage for the foundation is best left to the insurance agent. In fact, the Flood Insurance Manual specifically directs the agent to "[i]nclude the cost of the building foundation when determining the replacement cost value."[4] The lender should not be responsible for determining that the RCV appropriately values the foundation. Lenders are simply not equipped to make this determination. We would appreciate guidance indicating that, for purposes of agency compliance, the lender can rely on the replacement cost value assigned by the agent and that flood insurance in an amount equal to or greater than the hazard insurance RCV on the structure is proof of acceptable coverage.

Question and Answer 60: Can the 45-day notice period be accelerated by sending notice to the borrower prior to the actual date of the expiration for the flood insurance coverage?

Question and Answer 62: Does the lender or servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day period?

Proposed Q&A 62 would prohibit a servicer from charging for force-placed insurance that covers the 45-day notice period after the policy has lapsed. The agencies acknowledge in the preamble that this new policy will create a gap in insurance for at least 15 days. Q&A 60 prohibits the servicer from closing this gap by barring the servicer from starting the 45-day notice period prior to the expiration date of the policy. While Q&A 60 is not problematic if servicers are permitted to continue obtaining private insurance with retroactive coverage, it is problematic when combined with proposed Q&A 62.

Both Q&A 60 and 62 are extremely problematic and appear to reverse the efforts made by Congress in the National Flood Insurance Reform Act of 1994 (the Act) to enhance the National Flood Insurance Program. Rather than closing gaps in coverage, the proposed policy actually creates gaps in coverage and may reduce the borrower's protections. We

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[3] Federal Emergency Management Agency, National Flood Insurance Program, Standard Flood Insurance Policy, General Property Form, available at http://www.fema.gov/pdf/nfip/gpp127.pdf.

[4] Federal Emergency Management Agency, National Flood Insurance Program, Flood Insurance Manual, Page App 4, Column 1, October 1, 2009, available at http://www.fema.gov/pdf/nfip/manual200910/04app.pdf.

believe this is counter to the purpose and language of the Act, which calls for life of loan coverage, confirms the servicer's ability to force place coverage, confirms the servicer's ability to charge for the force-placed insurance, requires escrowing of flood insurance premiums on escrowed loans, and imposes penalties for failure to obtain the necessary coverage—all of which are designed to reduce lapses in flood insurance coverage.

The agencies indicate that the Act and Regulations do not provide authority for the lender to charge the borrower for coverage during this period. We believe the Act does not prohibit charging for coverage for the 45-day period and, in fact, permits the lender to charge the borrower for premiums and fees incurred. The specific statutory language states:

> (e) Placement of Flood Insurance by Lenders.--
> (1) *If, at the time of origination or at any time during the term of a loan* secured by improved real estate or by a mobile home located in an area that has been identified by the Director (at the time of the origination of the loan or at any time during the term of the loan) as an area having special flood hazards and in which flood insurance is available under the National Flood Insurance Act of 1968 [42 U.S.C. 4001 et seq.], the lender or servicer for the loan determines that the building or mobile home and any personal property securing the loan is not covered by flood insurance or is covered by such insurance in an amount less than the amount required for the property pursuant to paragraph (1), (2), or (3) of subsection (b) of this section, the lender or servicer shall notify the borrower under the loan that the borrower should obtain, at the borrower's expense, an amount of flood insurance for the building or mobile home and such personal property that is not less than the amount under subsection (b)(1) of this section, for the term of the loan.
>
> (2) Purchase of Coverage on Behalf of Borrower --
> If the borrower fails to purchase such flood insurance within 45 days after notification under paragraph (1), *the lender or servicer for the loan 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 for the loan in purchasing the insurance.*[5] (Emphasis added.)

There is no limitation on the scope of coverage for the lender-placed insurance and no express prohibition on charging a borrower for the lapse period if the borrower fails to perform pursuant to the notice. In fact, we argue that the law expressly permits charging a borrower for the retroactive insurance as demonstrated by the emphasized text above which states that the lender "may charge the borrower for the cost of premiums and fees incurred." Nowhere in the Act does the lender have to pay for the borrower's coverage, which is what is being proposed herein.

Borrowers also have a contractual duty to maintain insurance on the loan pursuant to the mortgage. Borrowers are notified of this duty at the time of origination and are informed that if the borrower fails to maintain insurance for the term of the loan, the lender will force-

[5] 42 U.S.C. §4012a(e).

place insurance at the borrower's expense. A lender-placed policy is merely a continuation or enforcement of the borrower's obligation to keep the insurance in force for the term of the loan. Nothing in the Act prohibits this common practice. Rather, the confirmation that lenders can charge borrowers for lender-placed insurance recognized and required the continuation of this practice.

The Act was passed as a result of losses sustained by the NFIP following the Great Midwest Flood of 1993. Studies performed by various government agencies identified several deficiencies in the program and the lack of penetration of flood insurance. As a result, mandatory purchase requirements were strengthened and penalties imposed on lenders for non-compliance. As stated previously, proposed Q&A 62 is in conflict with the purpose of the Act, which is restated in final rules issued by the agencies.

> "The Reform Act is intended to increase compliance with flood insurance requirements and participation in the NFIP in order to provide additional income to the National Flood Insurance Fund and to *decrease the financial burden of flooding on the Federal government, taxpayers, and flood victims."* [6] (Emphasis added.)

FEMA also recognized that the 1994 Act was designed to reduce the lapse in insurance coverage.

> "A key clarification of the 1994 Reform Act is that flood insurance must be obtained and maintained during the term of the loan. Regulated lending institutions and GSEs are responsible for providing notice of and requiring flood insurance coverage for the term of the loan on buildings located or to be located in any SFHA in participating communities. Flood insurance will be required even if the SFHA designation is first identified after settlement, but during the term of the loan. This requirement is designed to *combat coverage lapses* allowed to occur by individuals who believe they will not be flooded, and therefore discontinue payment of flood insurance premiums during the term of the loan.[7] (Emphasis added.)

In addition to our belief that the Act permits retroactive application of insurance benefits, there are other sound business and public policy reasons why the agencies should support the current practice.

First, by prohibiting retroactive coverage during the 45-day period, the proposed policy is exposing borrowers to loss. The agencies suggest that lenders purchase a blanket policy to cover the gap period. Blanket policies are single interest policies protecting only the lender's interest. As a result, the borrower may be exposed to losses. Conversely, private lender-placed insurance policy forms commonly utilized today can provide dual interest, replacement cost coverage (not available from the NFIP) and are often written at the last known coverage amount, which may provide the full replacement cost of the structure.

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[6] Loans in Areas Having Special Flood Hazards, Final Rule, 61 Fed Reg. 45684, 45685 (Aug. 29, 1996).

[7] FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, August 2008, p. 5.

Second, the agencies' proposed policy will likely result in more losses to the NFIP because lenders, unable to collect a premium from the borrower and not wishing to incur the cost themselves, will submit more claims under the 30-day extension granted by the NFIP policy form to mortgagees. Today, if losses occur during the 45-day period, most claims are made to the private flood insurer under the lender-placed policy that was effective on the date the NFIP policy expired. The end result is that the NFIP will suffer greater losses without obtaining the benefit of increased premiums (except on those where damage has occurred).

Third, it is important to point out that lender-placed insurance offered through private insurers provides a powerful benefit to borrowers, lenders and investors. These policies can provide full replacement cost coverage, yet the borrower incurs no cost for any period of duplicate coverage. If the borrower can demonstrate that he or she had flood insurance in place during the period of lender-placed coverage, the insurer will either waive the premium charge or refund the premiums if already invoiced. This occurs even if the borrower provides evidence of insurance outside of the 45-day period. Lenders are in compliance, yet the borrower is never "double charged" for coverage during the 45-day period. Only when the borrower fails to have insurance is the borrower actually charged for the time lender-placed insurance is in effect. The premium charge is not invoiced to the borrower until after the 45th day.

Fourth, the proposed policy would conflict with the government sponsored enterprises' (GSE) servicing requirements for flood insurance. A failure to provide coverage during the gap is a violation of the GSEs' guidelines. Fannie Mae's Seller/Servicer Guide provides, "…in all cases the servicer is responsible for ensuring that—whether through borrower-placed or lender-placed hazard insurance—there is no lapse in coverage."[8] This systematic lapse in coverage provides a financial risk not only to the investors, but to the servicers during this unwarranted waiting period. At this time, the GSEs do not allow "blanket policies" to substitute for lender-placed policies. It is apparent that the GSEs impose a "no-gap" policy to protect the collateral and reduce their risk of loss. We believe this is sound business and public policy.

Fifth, some smaller lenders may not be able to afford the cost of the blanket or force-placed policy and will go uninsured for the gap period, creating and even promoting unsafe and unsound lender practices.

Sixth, proposed Q&A 62 may encourage non-escrowed borrowers to delay renewal of flood policies if they believe such behavior benefits them by avoiding the cost of coverage for 45 days. This would be an undesirable result and create wide-spread compliance burdens and violations of investor agreements for servicers who must warrant that their loans are fully insured at all times.

In sum, we request that the agencies revise Q&A 62 to recognize the current practice of obtaining lender-placed coverage that covers the 45-day notice period and passing this

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[8] Fannie Mae, 2006 Servicing Guide, Part II, Chapter 6: Lender-Placed Property Insurance (02/01/05)

cost to the borrower to the extent that the borrower had not obtained his or her own coverage. If this were to occur, there is no need to change Q&A 60.

MBA and HPC appreciate the opportunity to offer our comments on this important subject. If you have any questions please contact Vicki Vidal, Associate Vice President, Loan Administration, Mortgage Bankers Association at (202)557-2861 or vvidal@mortgagebankers.org or Paul Leonard, Vice President of Government Affairs, Housing Policy Council at (202)289-4322 or paul@fsround.org.

Sincerely,

Housing Policy Council
Mortgage Bankers Association