American Bankers Association

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Re: The Force-Placement of Flood Insurance as a MIRE Event

Dear Ladies and Gentlemen:

The American Bankers Association[1] (ABA) wants to follow up on conversations we have had regarding whether the banking agencies consider the advancement of a premium to force-place flood insurance an "increase" of a designated loan, which as you are aware, is a statutory "tripwire" under the Flood Disaster Protection Act.[2] We are hearing increasing reports from our members that Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of Currency (OCC) examiners have taken the position that advancing a flood insurance premium in order to force-place flood insurance increases a loan balance and therefore constitutes a MIRE event.[3] This interpretation is new to the industry and is inconsistent with industry practice and contractual obligations under standard mortgage loan agreements. In addition, we believe it will result in significant borrower confusion and unnecessary borrower expense.

The mandatory purchase requirement prohibits a regulated lender from making, increasing, renewing, or extending (MIRE event) a designated loan "unless the building or mobile home and any personal property securing such loan is covered for the term of the loan by flood insurance in an amount at least equal to the

[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.
[2] 42 U.S.C. § 4012a (2014).
[3] FDIC examiners at an Iowa Bankers Association Compliance Conference in November 2015 and at a California Bankers Association "Day with the Regulators" event in April 2016 stated that force-placing flood insurance increases the loan and is considered a MIRE event. Additionally, at least one FDIC supervised bank and two OCC supervised banks have been cited for failing to include the force-placed flood premium in the loan amount.

outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular type of property, whichever is less."[4]

The FDPA further requires that any time the lender determines the flood insurance policy has expired or is insufficient in amount, the lender must notify the borrower that the borrower must obtain flood insurance coverage of at least the "outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular type of property, whichever is less."[5] If the borrower fails to do so within 45 days, the lender may force-place the insurance "on behalf of the borrower"[6] and charge the borrower for the "premiums and fees incurred by the lender or servicer . . . beginning on the date on which flood insurance coverage lapsed or did not provide a sufficient coverage amount."[7]

The plain language of the statute requires the bank to notify the borrower of the minimum amount of flood insurance that must be obtained – the unpaid loan balance if that is the least of the options – and then force place that amount if the borrower fails to do so. Although the bank subsequently may charge the borrower for the premium and fees incurred in purchasing the policy on behalf of the borrower, at the time the notice is provided and the force-placement is conducted, ***that amount is not part of the borrower's outstanding principal balance of the loan.***

While a bank may make an advance to protect its collateral in the form of purchasing a flood insurance policy – such protective advances under the note may only be added to the outstanding principal balance after they are actually paid by the lender. The lender cannot add the amount of the force placed premium to the outstanding principal balance of the loan preemptively, in anticipation of the borrower's failure to provide the insurance coverage required. Thus, force-placing an amount that includes the cost of the premium would require a bank to force-place an amount that exceeds the outstanding principal balance.

Fundamentally, the events Congress contemplated as statutory triggers for a bank's compliance obligations under the FDPA – making, increasing, extending, or renewing a loan – are borrower initiated events. As they represent a new transaction between the borrower and lender, they often require new credit underwriting and the execution of a new note, or some other affirmative action by the borrower, that reflects the amended contractual obligation. In contrast, a protective advance by the lender of a force placed flood insurance premium is the exercise by the lender of a pre-authorized contractual obligation under the existing agreement. Standard security agreements include provisions that obligate the borrower to keep the property insured, and in the event of a breach, permit the lender to make protective advances to procure and pay for insurance. Although those advances may increase the overall amount owed to the lender, the advance of the premium by the lender does not "increase" the loan amount in the manner the FDPA contemplates as a statutory trigger.

Indeed, if adding the flood insurance premium to the loan is considered to increase the loan amount, following that logic through, the payment of a force-placed hazard insurance premium, taxes, or even a late fee would also "increase" the loan—and result in a MIRE event as it is wholly inconsistent to treat these protective advances differently. Accordingly, a delinquent borrower could experience a "MIRE event" as frequently as monthly with each late payment. Clearly, this was not Congress's intent.

We also urge you to consider the potential borrower harm that will result from this interpretation. For a lender to comply, the lender must *estimate* the amount of the premium and fees. On occasion, the estimate may vary from the amount of the policy. In these situations, must a lender notify the borrower of the deficiency and begin force placement procedures again for the difference? And how should a lender

[4] 42 U.S.C. § 4012a(b)(1)(A).
[5] *Id.* at 4012a(b)(1)(A); 4012a(e)(1).
[6] *Id.* at 4012a(e)(2).
[7] *Id.*

proceed if the premium is lower than estimated? Will the lender need to reduce the amount of insurance force-placed?

In addition, some borrowers promptly pay the force-placed premium balance in full, particularly in those situations in which borrowers prefer force-placed insurance because it is cheaper than the flood insurance options available to them directly. In these situations, if the lender preemptively force-places an amount which includes both the unpaid loan balance and the premium, and then the borrower pays the flood insurance premium and fees, the lender will have force-placed too much insurance.

However the alternative, the lender waiting until the force-placed premium and fees are actually charged and then added to the borrower's account, is equally problematic. This will force borrowers and lenders into a never-ending cycle of increasing a borrower's flood insurance and charging an additional premium (and potentially fees) at significant cost and confusion to the borrower. After all, a MIRE event triggers anew the requirements of FDPA. Each time a lender is required to force-place flood insurance, the lender will be required to obtain a new special flood hazard determination, provide new notices to the borrower, and commence mandatory escrow. This will not only increase the overall cost of lending for borrowers, but the new notices may confuse borrowers and the implementation of mandatory escrow will significantly, and unexpectedly, increase a borrower's monthly payment.

As noted at the outset of this letter, it is unclear whether this interpretation reflects the position of all of the banking agencies, but with each new report that an examiner has taken this position, there is increased concern among our members. We urge you to issue interagency guidance that clearly states whether the advance of flood insurance premiums is considered a MIRE event, and if so, to clarify that this obligation is prospective and to state how, and in what circumstances, a lender can avoid creating a MIRE event when meeting its statutory obligation to force-place flood insurance.

Sincerely,

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