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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

Ladies and Gentlemen:

Wells Fargo Bank, National Association ("Wells Fargo") respectfully submits the following comments on the proposed "Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance" Additional Comments (the "Additional Questions and Answers"), issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Farm Credit Administration, and the National Credit Union Administration (collectively, the 'Agencies").

September 21, 2009

Summary of General Concerns

Wells Fargo again welcomes clarification of banks' and other regulated lenders' regulatory obligations under the National Flood Insurance Reform Act of 1994 (NFIRA) and its accompanying regulations. While the additional proposed Questions and Answers provide additional guidance on interpretation and application, Wells Fargo is concerned that the Additional Questions and Answers need to be revised in certain respects to achieve the goals of the Act and accompanying regulations.

Specific Comments

Question 9. What is the insurable value of a building?

The full insurable value of a structure is not the same as 100 percent replacement cost value (RCV). We believe, when computing the insurable value of a building, the valuation clause in the applicable flood insurance policy must be considered. Therefore, the RCV should not in all cases be the amount constituting adequate coverage (if that amount were less than the principal balance of the applicable loan).

In FEMA's Dwelling Form Policy (DP) and in the Residential Condominium Building Association Policy (RCBAP), the policy Loss Settlement clause indicates that loss settlement will be on an RCV basis, subject to certain terms and conditions in the policy. For example, dwellings that are not the principal residence of the insured are not eligible for loss settlement based on RCV.

In the FEMA General Property Form, which applies to all non-residential properties, the Loss Settlement clause provides for loss settlement on an Actual Cash Value (ACV) basis, defined in the policy as the cost to replace the property item less the value of the physical depreciation.

Using FEMA guidelines, the proposed answer suggests that the insurable value is always the RCV, except for buildings used for ranching, farming or industrial purposes. In reality, since certain residential structures (such as non-owner occupied dwellings) and all commercial structures are only eligible for loss settlement on an ACV basis, we believe it is not correct to always use the RCV as the full insurable value.

While the guidance on "functional building cost value" or "demolition/removal cost value" will be helpful where appropriate, we would suggest that these values are, in specific cases, the "insurable value" of these particular structures. There are also situations where the appropriate insurable value is the ACV. We believe that FEMA overstates the issues by declaring that the value of a structure is the same as 100 percent of the RCV. For example: For a loan with a balance of $300,000 on a small, older, rural, frame constructed church, the RCV could be over $250,000 – but the property could easily be 50% depreciated and have an ACV of $125,000. In this case, if the building were to be rebuilt it would be rebuilt as a church so neither the functional building cost value nor the demolition/removal cost value would be appropriate. The correct insurable value on this property, insured under an NFIP General Property Form is the ACV, or $125,000. The borrower should not bear the burden of over-insuring, nor lenders the criticism for requiring over-insurance by requiring the borrower to provide $250,000 of coverage on this building when the maximum loss payable under the terms of the NFIP policy is the ACV.

Additionally, we suggest that the Agencies, including FEMA, require that flood insurance providers establish and display the insurable value of every building on all evidence of insurance, just as it is done today on the RCBAP. If this were mandated, then lenders would not need to delay processing to try to evaluate or obtain the insurable value. Ultimately, the flood insurance provider has the responsibility to the insured to establish the correct amount of insurance and the lender should not be engaged in that process.

Question 10. Are there alternative approaches to determining the insurable value of a building?

We agree with and appreciate the guidance and flexibility the Agencies are suggesting to use functional building replacement cost value or demolition/removal cost value for certain types of properties where appropriate. However, we think the utilization of these values should be expanded to properties used for any purpose. For example, the property could be a former gas station that has been converted into an office or retail store. It would be unreasonable to require that borrower to purchase RCV coverage when he would never rebuild that style of building, and the General Property Form would not settle the loss on an RCV basis. Allowing all occupancies to utilize the alternate approaches (including ACV) to determine the insurable value is necessary. As stated in our comments in Question 9 above, Actual Cash Value (ACV) is another alternative to determine the appropriate insurable value for certain occupancies.

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

We believe that neither the Act nor the regulation requires that the 45-day period begin at the actual date of expiration of coverage. However, we do not object to this interpretation if the answer to Question 62 is revised as suggested below.

Question 61. When must the lender have flood insurance in place if the borrower has not obtained adequate insurance within the 45-day notice period?

We appreciate the Agencies' flexibility in allowing a brief delay; however, we propose that an example and additional clarification be added to the Answer so that it takes into consideration automation and cycle times. We propose that the following Answer be provided:

> "**Answer:** The regulation provides that the lender or its servicer shall purchase insurance on the borrower's behalf if the borrower fails to obtain adequate flood insurance within 45 days after notification. However, if the lender can demonstrate that it has adequate controls in place for issuing the force placed policy to the borrower within a reasonable time from the date of the 45-day notification to the borrower, and that the **effective date** of the force placed coverage is not greater than day 50 after the date of the 45-day notice to the borrower, then the Agencies will interpret the force place coverage time frame as having been met.
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> The following example supports a typical automated cycle of 70 days from discovery (60 days from notice); however, there is no lapse in coverage and the lender and borrower are protected by the binder coverage and effective date of the actual force placed policy:

Example:

- 08/03/09 - Voluntary flood policy expired
- 08/07/09 - Batch report is generated on Fridays
- 08/10/09 - Batch report received
- 08/11/09 - Batch report processed
- 08/13/09 - 45-day notice sent to borrower
- 09/12//09 - Binder notice issued 30 days after 45-day notice sent
- 10/12/09 - Issue force placed policy (effective date as of 08/03/09 voluntary policy expired) notice sent 30 days after binder notice"

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

We suggest this Question and Answer be revised for a number of reasons.

We believe the fundamental question is: Do the Act and Regulation *require certain actions on the part of the lender* if a borrower fails to maintain insurance, or do the Act and Regulation *grant the borrower 45 days of "grace" in which to comply* with the Act and Regulation. We believe it is the former. None of the Act, the Regulation, or the FEMA NFIP policy forms state that the 45 day window is anything other than a *notice period.*

The Act and Regulation *require a lender to force place* flood insurance if, after required notice, the borrower fails to purchase the appropriate amount of coverage. If adequate insurance is not obtained by the borrower within the 45-day notice period, then the lender or servicer must purchase insurance *"on behalf of the borrower."* [emphasis added] The guidance from the Agencies provided in Question 57 states: "The Act and Regulation *require the lender, or its servicer, to send notice* to the borrower upon making a determination that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider." The guidance from the Agencies provided in the proposed answer to Question 61 further states: "The Regulation provides that the *lender or its servicer shall purchase insurance* on the borrower's behalf if the borrower fails to obtain flood insurance within 45 days after notification." [emphasis added by Agencies]

In addition, the FEMA Policy Language makes clear that the 45 day window is NOT a grace period. The full amount of flood insurance coverage that was provided under the NFIP policy form is not extended for 45 days. The FEMA NFIP Dwelling Policy form states in Section **H, Policy Renewal: "1.** This **policy** will expire at 12:01 a.m. on the last day of the **policy** term. **2.** We must receive the payment of the appropriate renewal premium within 30 days of the expiration date." Consequently, FEMA does allow the insured/borrower to remit the premium up to 30 days late and will still honor the renewal offer and issue the renewal policy with no gap in coverage; however, if the premium is not paid in the 30 day window, coverage will have expired on the last day of the policy term and there is no extension. Therefore, any borrower who never pays the premium ultimately has no coverage after policy expiration.

The policy form further states, in Section **Q, Mortgage Clause:** "If we deny your claim, that denial will not apply to a valid claim of the mortgagee, if the mortgagee: . . . **2.** Pays any premium due under this **policy** on demand if you [the borrower] have neglected to pay the premium; and . . . If we decide to cancel or not renew this **policy,** it will continue in effect for the benefit of the mortgagee only for 30 days after we notify the mortgagee of the cancellation or nonrenewal. . . If we pay the mortgagee for any loss and deny payment to you, we are subrogated to all the rights of the mortgagee granted under the mortgage on the property. Subrogation will not impair the right of the mortgagee to recover the full amount of the mortgagee's claim."

This paragraph means that if the policy lapses and the mortgagee submits a claim, in order for the claim to be paid, the mortgagee will need to pay any premium due as a condition to payment of the claim. The policy will be extended for 30 days after the insurer has notified the mortgagee of the cancellation or nonrenewal, but only for the benefit of the mortgagee. If the insurer pays a claim in this situation, the insurer is subrogated to the rights of the mortgagee. As a result, if the mortgage is paid off with the insurance proceeds, the borrower still has a damaged home and now is indebted to the insurer for the amount of the mortgage. If Congress intended to provide a "free" flood insurance extension for 45 days after a flood policy expiration date, then the Act, Regulation or the NFIP policy form could have been drafted so that every policy provided coverage for all parties for a term which included the 45 day notice period.

While we agree that the Act and Regulation do not *specifically* authorize the lender or servicer to charge a borrower for a force placed policy until the 45 day notice period has expired, we suggest a reasonable interpretation should not require that a lender or an insurer provide free flood insurance coverage during the 45 day notice period. The intention of the 45 day period is to require the lender to provide notice to the borrower of the requirement to maintain insurance prior to force placing coverage, if necessary.

Throughout the Q&A, the Agencies have provided guidance indicating that "lenders have discretion" about requiring flood insurance coverage in situations where it is not required by the Act or Regulation (non-participating communities (Q1), after a property has been removed from the SFHA (Q2), or in an amount greater than the minimum coverage required by the Act or Regulation (purchased loans (Q2), participation loans (Q3) and in Q16). Allowing lenders to require, or force place coverage for the full insurable value of the property for the complete term of the loan with no gap in coverage is consistent with the intent of the Act, and in the best interest of the borrower and the lender.

In addition, most current mortgage loan documents require the borrower to continuously maintain the insurance required by the lender. Failure to maintain the required insurance is a breach of the loan documents. Further, the borrower specifically authorizes the lender to place insurance on the collateral in the event the borrower fails to maintain the required insurance. There is no provision for any grace period or lapse, nor any agreement on the part of the parties for the lender to allow the property to be uninsured or underinsured for any period of time. Mortgage investors, including Freddie Mac and Fannie Mae, require that the collateral be insured at all times.[1]

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[1] Specifically, the Freddie Mac Single Family Seller/Servicer Guide states: "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." Fannie Mae's 2006 Servicing Guide states: "We require that any mortgage secured by a property located in a Special Flood Hazard Area have

Our objective as a lender is to keep the property continuously insured. If a borrower pays the required premium so that the payment is received within 30 days after the policy expiration date, the NFIP will normally honor that premium payment and issue the renewal policy with no gap in coverage. However, if the borrower pays the premium late, so that it is received after day 30, not only is there no coverage for the borrower for the first 30 days, but it is also likely there will be an additional 30 day waiting period before a new NFIP policy is effective, creating a 60 day lapse in voluntary coverage. Prohibiting lenders from charging borrowers a premium for this force placed insurance to guard against this lapse in coverage (Day 1 to Day 45) and breach in the mortgage agreement will force lenders to make force placed coverage effective on day 46, leaving the borrower totally uninsured for a 45 day period of time.

A lender that provides a private, dual interest, force placed insurance program, with the policy ordered after Day 45, but effective retroactive to Day 1, can provide continuous coverage to protect the property, and the interests of the borrower, the lender, and the investor. Borrowers are charged a premium for the force placed insurance coverage for only the exact number of days for which there was no other insurance. Coverage can be provided for the full RCV. There is no subrogation right or penalty imposed on the borrower. We understand FEMA does not offer a force placed insurance policy to lenders that will fill this need, however, lenders and insurers have created private force placed products that have been used for many years, specifically tailored to address this gap in coverage. Allowing lenders to use this product and charge borrowers for the premium if no other coverage is in effect is in the best interest of all parties.

Finally, we ask that the Question and Answer 62 be restated as follows to clarify the situation in which it is acceptable to charge the borrower for the period beginning on the customer's voluntary policy expiration date.

> **Question 62. If the borrower does not provide proof that the voluntary flood insurance policy was renewed, does the lender or the servicer have the authority to charge a borrower for a force placed flood insurance policy issued with an effective date as of the date the borrower's voluntary flood insurance policy expired?**
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> **Answer:** Yes, if the loan documents provide a contractual right to do so. The terms of the borrower's voluntary flood insurance policy allow 30 days after the due date for the premium to be submitted before there is a lapse in coverage. Therefore, if the borrower does not pay the premium within 30 days of the expiration date, then the borrower does not have any flood insurance coverage for the period beginning on the voluntary policy expiration date. The Act requires that when a lender discovers an uninsured or underinsured situation, the lender must first notify the borrower and give the customer 45 days to provide proof of coverage, and then the lender must force place coverage. In this case, on or after day 46 of the required notice, the lender or servicer may protect both the borrower's interest and the lender's interest by issuing a force placed policy with an effective date as of the date the borrower's voluntary flood insurance policy expired.

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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. . .A servicer must make sure that the properties that secure mortgages it services for us are adequately protected by flood insurance when it is required, *with no lapses of coverage for any reason.*"

Section VII: Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA

We wish to point out that there is still uncertainty for the junior lender concerning force placed coverage, and we respectfully request that the Agencies consider providing further guidance on this issue by publishing for comment additional proposed guidance.

We agree with the guidance provided by the Agencies in Q&A 36, concerning the responsibilities of the junior lender at the origination of the second mortgage. We understand the need to coordinate the flood insurance coverage with the senior lender at loan inception to protect the interest of the junior lender.

In the previous opportunity to comment, we noted that the Proposed Question and Answer 32 (now Question and Answer 36) address the amount of flood insurance required when a lender makes a loan secured by a second mortgage on a building or mobile home located in an SFHA but that Question and Answer 32 did not address the amount of coverage that the junior lender should force place if the voluntary insurance coverage is not maintained by the borrower. We suggested that a junior lender who utilizes the NFIP's Mortgage Portfolio Protection Program (MPPP) must coordinate MPPP coverage with the senior lender to protect the junior interests, obtain a copy of any existing MPPP (placed by the senior lender), and assess the sufficiency of the flood insurance coverage. The minimum force placed flood coverage required is the lesser of a) the total aggregate amount of all outstanding loans for both lenders, or b) the full insurable value of the building, defined as 100% of the replacement cost (or RCV) of the improvements on the mortgaged property, or c) the maximum amount of coverage available under the NFIP for the particular type of building.

We previously suggested that it will be difficult for a junior lender, faced with the need to force place coverage, to coordinate the force placed flood insurance with the senior lender. In many cases the senior lender may have modified, sold or transferred the servicing of the loan to another lender making it difficult (if not impossible) for the junior lender to identify the senior lender (or its servicer), in order to determine the amount of force placed coverage the senior lender has put in effect. In the event that the junior lender is successful in contacting the senior lender, in all likelihood, the senior lender will have ordered force placed coverage from a private flood insurance provider that protects only the senior lender's (and perhaps the borrower's) interest and may be only in the amount of the senior lender's lien.

In the Answer to Question 36 the Agencies commented:

"In the limited situation where a junior lienholder or its servicer is unable to obtain the necessary information about the amount of flood insurance in place on the outstanding balance of a senior lien (for example, in the context of a loan renewal), the lender may presume that the amount of insurance coverage relating to the senior lien in place at the time the junior lien was first established (provided that the amount of flood insurance relating to the senior lien was adequate at the time) continues to be sufficient."

Following the logic in the previous paragraph, the junior lender, faced with the need to force place, should be able to presume that the senior lender has the same statutory obligation to force place to protect the senior lien and will do so. That would leave the junior lender with a need to force place for the amount of its principal balance to comply with the Agencies answer in Question and Answer 8.

September 21, 2009

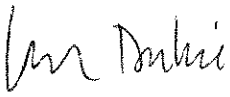
If the junior lender utilizes acceptable private flood insurance for its force placed insurance program, where the junior lender is a named insured on its own force placed policy, the junior lender independently protects its interest and complies with its statutory obligation to force place coverage and there should be no further requirement to coordinate with the senior lender. The senior lender will independently force place for its principal balance. The junior lender will independently force place for its principal balance. Total indebtedness would be covered.

We understand FEMA does not offer a force placed insurance policy to lenders that will fill this need, however, lenders and insurers have created private force placed products that have been used for many years and are effectively providing coverage for the interest of junior lenders without imposing unnecessary burdens on lenders. Lenders should be allowed to use this option as it fulfills the statutory requirement as respects force placement.

We need guidance from the Agencies on this issue. If the Agencies are unable to assist us, junior lender will need to attempt to coordinate with senior lenders at the time force placement is required, involving significant time and expense – only to find that the senior lender has in fact fulfilled its statutory obligation and has ordered force placed coverage to protect its interest. Since the statute requires the senior lender to force place coverage, the junior lender should be allowed to presume the senior lender will comply with the statute. If the junior lender is unable to coordinate with the senior lender, the junior lender would be compelled (absent guidance that provides an option) to force place for the total liens on the property, almost certainly causing duplicate force placed coverage to the detriment of the borrower and subsequent borrower complaints of abusive practices by lenders.

Questions regarding these comments may be directed to the undersigned at (215) 670-6873 or via e-mail at carol.dubie@wachovia.com.

Very truly yours,



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