

COMMENTS
to
OCC, FDIC, NCUA, FRB, and FCA

regarding

12 CFR Parts 22, 172, 208, 339, 614, and 760
Docket ID OCC–2014–0016,
FRB Docket No. R–1498

RINs 1557–AD84, 7100–AE22, 3064–AE27,
3052–AC93, and 3133–AE40

79 Fed. Reg. 64, 518 (Oct. 30, 2014)

Loans in Areas Having Special Flood Hazards

by the
National Consumer Law Center
on behalf of its low income clients

December 29, 2014

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The National Consumer Law Center ("NCLC")¹ submits the following comments on behalf of its low-income clients.

I. Introduction

In October 2013 the Agencies published a proposal² to implement aspects of the Biggert-Waters Flood Insurance Reform Act of 2012.³ Subsequently, the Agencies amended the 2013 proposal (a final version of which has not yet been released) to make adjustments required by the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA).⁴ While the more recent amended proposal only addresses changes required by the HFIAA, the Supplementary Information discusses issues common to both the original 2013 proposal and the amended proposal. Accordingly, these comments focus on the most recent proposal but also address broader issues common to the Agencies' supervision of flood insurance requirements.

In particular:

- The Agencies should take steps to minimize the negative consequences of the statutory HELOC exemption by defining a HELOC in a manner that excludes open-end mortgages that are fully drawn at closing.
- The Agencies have authority to require servicers to advance the cost of voluntary flood insurance premiums to prevent cancellation for non-payment. The Agencies should exercise their authority to do so.
- If the Agencies decline to exercise that authority, they should coordinate with the Consumer Financial Protection Bureau so the CFPB can impose this requirement.

¹ The **National Consumer Law Center**® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including *Mortgage Lending and Foreclosures & Mortgage Servicing*. These comments were written by NCLC attorney Andrew Pizor.

² 78 Fed. Reg. 65108 (Oct. 30, 2013).

³ Pub. L. 112-141, 126 Stat. 916 (2012).

⁴ Pub. L. 113-89, 128 Stat. 1020 (2014).

- The Agencies should set a clear maximum on the amount of flood insurance coverage that regulated institutions may require borrowers to purchase. That maximum should be the amount of the outstanding principal loan balance or the highest coverage amount available under the National Flood Insurance Act, whichever is less. Borrowers can purchase more coverage if they want it, but lenders should not be able to force them to insure an amount greater than the principal balance of the lender's mortgage loan.
- We support the proposal to require small lenders to offer escrow accounts after they cease to qualify for the small-lender exemption, but we recommend improving the mandatory borrower notices.

We also renew our previous recommendation, stated in comments submitted on October 30, 2013, that the Agencies prohibit servicers and lenders from having a financial interest in any insurance they force-place.

II. The Agencies can and should do more to reduce the need for force-placed flood insurance.

A. The Agencies have authority to require servicers to advance the cost of voluntary flood insurance premiums and should do so.

Mortgage servicers often force-place flood insurance when the borrower's voluntary policy lapses for non-payment. The Consumer Financial Protection Bureau recently adopted a rule that requires servicers to advance the cost of those premiums, rather than allowing the policy to lapse.⁵ We previously urged the Agencies to adopt a similar requirement for flood insurance. In the Agencies' recent Federal Register notice, however, the Agencies expressed the view that they lack authority to do so under federal flood-insurance statutes.⁶

Although the Agencies do not explain how they reached this conclusion, the National Flood Insurance Act of 1968, the Flood Disaster Protection Act of 1973, and the Agencies' general regulatory authority appear to provide sufficient grounds for imposing such a mandate. Title 42, section 4012a specifically says Agencies "shall by regulation direct regulated lending institutions . . . not to" make mortgages on properties in flood hazard areas unless the mortgaged building is adequately covered by flood insurance "for the term of the loan"⁷ Elsewhere, the National Bank Act, the Federal Deposit Insurance Act, and other federal banking statutes authorize the Agencies to regulate lending institutions for safety and soundness. These grants of authority empower the Agencies to require servicers to advance

⁵ 12 C.F.R. § 1024.17(k)(2) (requiring servicers to pay escrowed items if the borrower is not more than 30 days in arrears on the mortgage principal and interest payment).

⁶ See 79 Fed. Reg. 64518, 64523 n.27.

⁷ 42 U.S.C. § 4012a(b)(1)(A).

the cost of voluntary flood insurance premiums when the servicer or the owner of the loan is regulated by one of the Agencies.

The Agencies have already exercised this authority by requiring servicers to purchase and impose force-placed insurance when a borrower fails to maintain a voluntary flood-insurance policy during the term of a mortgage.⁸ As stated in the FDIC's regulations: "If the borrower fails to obtain flood insurance . . . after notification, then the bank or its servicer shall purchase insurance on the borrower's behalf. The bank or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance."

We recommend amending this regulation to provide that the bank or its servicer shall pay the premiums on the borrower's existing, voluntary policy if the borrower fails to do so. The servicer may then charge the borrower for the cost of the premiums and fees incurred in *maintaining* the insurance. This requirement is nearly identical to the existing requirement already in place. The only difference is that the cost will be less, for both the servicer and the borrower. Such a requirement would save banks money and reduce their exposure to the unreimbursed cost of maintaining flood insurance.

Currently servicers must advance the cost of force-placed insurance (which is substantially greater than voluntary insurance), and then seek reimbursement from the borrower. Because this situation usually arises when borrowers are financially distressed, the servicer faces a significant risk that it will be out-of-pocket until the loan is foreclosed. Anything the servicer can do to reduce that cost will inure to the safety and soundness of the bank that services or owns the loan. Requiring servicers to advance the premiums on voluntary coverage will help both servicers and borrowers avoid the cost of force-placed coverage.

The Agencies already have authority to require servicers to advance the cost of flood insurance--and the Agencies have already done so for force-placed insurance. We recommend that the Agencies simply modify their existing rule by extending it to existing policies. This will be safer for borrowers, regulated lending institutions, and the National Flood Insurance Program.

B. The Agencies should coordinate with the CFPB to eliminate any loopholes created by the pending rules.

In 2013 the CFPB amended Regulation X by adding new provisions addressing the escrowing of hazard insurance premiums and the handling of force-placed insurance. The Bureau, however, exempted flood insurance (to the extent mandated for properties in special hazard flood areas) from these new provisions. The Bureau did so to avoid conflict with the

⁸ See, e.g., 12 C.F.R. § 22.7.

regulations for mandatory flood insurance.⁹ At the time, this was a reasonable decision because the Bigger-Waters regulations had not yet been proposed. But now, in light of the Agencies' proposed flood-insurance regulations, there is the potential for a gap in the insurance regulations.

In the event that the Agencies decline to require servicers to advance the cost of flood-insurance premiums, the Agencies should coordinate with the CFPB to eliminate this gap. If the proposed rules are finalized without changes in this regard, a servicer will be required to advance the cost of non-flood-hazard insurance *and* flood insurance required by the servicer (for borrowers not in special flood hazard areas). But the same servicer would not be required to advance the premiums for voluntary flood insurance for flood insurance mandated by the FDPA. There is no rational explanation for this difference. And it will inevitably confuse servicers and homeowners. If the Agencies decline to close this loophole, they should ask the CFPB to close it by amending Regulation X.

III. Set a clear maximum on the amount of coverage that regulated institutions may require.

The flood-insurance statutes, the existing regulations, and the proposed regulations set a minimum amount of coverage for homes in special hazard flood areas: an amount at least equal to the lesser of the outstanding principal balance of the loan or the maximum coverage available under the National Flood Insurance Act.¹⁰ But there is disagreement over whether that amount is also the maximum that lenders may demand of borrowers.¹¹ The failure to clearly impose a maximum has caused a significant amount of litigation and hardship for borrowers owning homes with substantial equity. In these cases, too many servicers have demanded more coverage than the minimum required by law, often demanding full replacement coverage rather than accepting coverage sufficient to pay off the loan.

The banking agencies should end this abuse by clearly stating that the minimum is also the maximum amount of coverage that may be required. If borrowers with significant equity want to purchase full coverage, they may do so. But lenders should not be able to force them to purchase more coverage than needed to pay off the mortgage.

Flood insurance is increasingly expensive and promises to become more so. The difference in cost between the minimum required by the law and full-replacement coverage can make homeownership unaffordable and drive borrowers into foreclosure. This is

⁹ 78 Fed. Reg. 10696, 10723 (2013).

¹⁰ *See, e.g.*, 12 C.F.R. § 22.3(a).

¹¹ *See* Kolbe v. BAC Home Loans Servicing, L.P., 738 F.3d 432 (1st Cir. 2013) (requiring excess flood insurance did not breach contract or implied covenant of good faith and fair dealing) (en banc, 3-3 split).

particularly true for those who have nearly paid off their loans and those living on a fixed-income. While we recommend that homeowners be fully insured, the reality is that many lower-income homeowners must choose between partial coverage and giving up their homes.

The Agencies should not allow mortgage servicers to push these borrowers over the edge by demanding unreasonable amounts of insurance coverage. The amount of coverage that exceeds the loan balance does not increase safety and soundness. Instead it more likely threatens the safety of the loan by putting an additional, and potentially unaffordable, financial burden on the borrower. Some states, such as Massachusetts, already limit the amount of coverage a servicer may demand.¹²

The regulations should also specify that, when force-placed insurance is required, lenders should impose coverage at the last known amount. Where that amount is not known, lenders should be allowed to place no more than the minimum coverage required by law. The borrower can always purchase more coverage if she wants. But, given the high cost of flood insurance (especially force-placed flood insurance), servicers should not be allowed to impose more coverage than required by law.

IV. Exempting fully-drawn HELOCs encourages steering and abuse.

A. Overview

The HFIAA added a new exemption from the flood-insurance escrow requirement for home equity lines of credit (HELOCs).¹³ As the Supplementary Information observes, many who commented on the October 2013 Proposal requested such an exemption. But this exemption increases the risk that disreputable originators will steer borrowers to HELOCs for inappropriate reasons.

In recent years Congress and regulatory agencies have significantly improved consumer protections for mortgages. But HELOCs have been left behind. The regulations implementing the Truth in Lending Act, the Real Estate Settlement Procedures Act, and Home Mortgage Disclosure Act all currently exempt HELOCs from significant provisions.¹⁴ Now Congress has added the Flood Disaster Protection Act to that list.

This is a problem because, as the restrictions on closed-end mortgages grow, originators will look for ways to avoid them. The most obvious way, in many cases, will be

¹² Imposing such a rule at the federal level would not affect state regulation of the insurance business because the Agencies would be regulating the mortgage holder and servicer--not the insurer.

¹³ *Id.* § 25(a).

¹⁴ See Nat'l Consumer Law Ctr., Home Equity Lines of Credit Gaps in Coverage & Exemptions from Regulations (Dec. 2014), attached as Exh. A.

to characterize a closed-end loan as a fully-drawn HELOC. Doing so will enable an originator to disclose an APR that excludes onerous, prepaid finance charges; to charge yield spread premiums; to make loans without regard to the borrower's ability to repay; to avoid the new disclosure rules taking effect in August 2015; and to avoid reporting HMDA data. It will also exempt the servicer of that loan from many consumer protections such as the duty to respond to notices of error and requests for information, the duty to identify the mortgage owner, the early intervention requirements, the duty to comply with loss-mitigation procedures, and the continuity of contact requirements.

Now originators will have an additional tool, besides deception, to attract closed-end borrowers: "Get a HELOC instead! You won't need to escrow your flood insurance!"

B. The Agencies can prevent abuse by defining "HELOC" to exclude fully-drawn lines of credit.

The Flood Disaster Prevention Act, as amended, does not define "home equity line of credit." And, for purposes of the flood-insurance regulations, a fully-drawn HELOC is essentially the same as a closed-end loan for the same amount—particularly with larger loans. Both put the borrower's dwelling at risk. Both expose the lending institution to credit and default risks. And both expose the National Flood Insurance Program to the risk of a loss. The fact that the borrower can (theoretically) make additional draws after paying down the line of credit does not change the risk to all parties involved.

Requiring a borrower to escrow for flood insurance protects the insurance fund and the mortgage holder. Congress recognized this fact by mandating escrow accounts for mortgages in special flood hazard areas. The statutory exemption for HELOCs, however, will allow lenders to originate fully-drawn, first-lien HELOCs without escrowing for flood insurance (as well as subordinate HELOCs where the first mortgage does not require an escrow account). This will be allowed even though the risk to all parties is the same as presented by a closed-end loan of the same size.

Existing rules prohibiting "spurious open-end credit" are insufficient to address the problem posed by HFIAA's new HELOC exemption. A fully-drawn HELOC need not be spurious to expose banks, borrowers, and the insurance fund to the harm that results from steering a borrower into an inappropriate HELOC and a loan without an escrow account.

The Agencies can mitigate this risk by defining "home equity line of credit" as a dwelling-secured line of credit that is less than fully drawn at closing.¹⁵

¹⁵ We recommend specifying an amount less than 100% to avoid subterfuge, such as limiting the exemption to HELOCs that are less than 75% drawn.

V. The proposal for former small lenders is good but notices must be improved.

The Agencies also requested comment on the proposal to require small lenders to offer existing borrowers the option to begin escrowing if the lender ceases to qualify for the small-lender exemption. We support this proposal and believe it will protect borrowers without overburdening lenders. If a lender no longer qualifies for the exemption, it can be presumed to have the capacity to offer escrow accounts to new and existing customers.

As suggested by the Agencies, such lenders should be required to notify borrowers of the option to begin escrowing. But electronic notice should only be permitted in addition to written notice. Borrowers who have previously consented to receive electronic communications may have become accustomed to ignoring routine notices (such as monthly statements). And such a borrower may easily overlook unusual notices such as this one. Notice of the right to begin escrowing is so important that lenders should be required to inform borrowers by mail to increase the likelihood that borrowers will read it.

The Agencies should also require that the notice, and all others mandated by the flood rules, be conspicuous and segregated from any other correspondence sent to the borrower. The sample notice in the proposed Appendix is too inconspicuous and may easily be overlooked by borrowers. Overlooking these notices could lead to the imposition of costly force-placed insurance. Therefore it is reasonable to require lenders to format notices in a manner that will catch the typical consumer's attention.

Exhibit A



Home Equity Lines of Credit Gaps in Coverage & Exemptions from Regulations December 2014

HMDA

- HMDA reporting is incomplete:¹⁶
 - *Optional* for dwelling-secured home purchase and home improvement HELOCs
 - *Mandatory* for dwelling-secured refinance and non-dwelling-secured home improvement HELOCs
 - The CFPB is proposing to require reporting for all dwelling-secured HEL/HELOC/reverse mortgages and to get rid of reporting for unsecured loans
 - We encourage support for this

TILA

- Major gaps and weaknesses:
 - Provision for statutory damages is unclear, at best, and there is no minimum--the only clause applicable is the first one in 12 U.S.C. § 1640(a)(2)(A):

“(2)(A) (i) in the case of an individual action twice the amount of any finance charge in connection with the transaction,”
 - APR only includes interest--no other fees.¹⁷
 - Reg. Z's loan originator comp. rules do not apply, meaning yield spread premiums are still legal for HELOCs.¹⁸
 - No duty to determine whether consumer has a reasonable ability to repay the loan (ability-to-repay rule).¹⁹
 - EFTA does not apply to HELOCs²⁰

¹⁶ See CFPB SBREFA Panel Outline of Proposals at 6 (summarizing current HMDA requirements), available at http://files.consumerfinance.gov/f/201402_cfpb_hmda_outline-of-proposals.pdf.

¹⁷ Reg. Z §§ 1026.6(a)(3)(vi), 1026.14(c)(3). See National Consumer Law Center, Truth in Lending § 8.1.5 (8th ed. 2012 and Supp.).

¹⁸ Reg. Z § 1026.36(b).

¹⁹ Reg. Z § 1026.43(a)(1) (excluding HELOCs from ATR rule).

²⁰ See *Shames-Yeakel v. Citizens Fin. Bank*, 677 F. Supp. 2d 994 (N.D. Ill. 2009).

- The new TILA/RESPA combined disclosures don't apply to HELOCs and the existing disclosures are inadequate.

RESPA

- Regulation X's servicing rules do not apply to HELOCs whenever the term "mortgage loan"²¹ is used:
 - Duty to Provide Transfer of Servicing Statement and 60-day Payment Safe Harbor.²²
 - Duty to Respond to Notice of Error and Request for Information²³
 - Duty to Respond to Request for Identity of Mortgage Owner²⁴
 - General Servicing Requirements²⁵
 - Early Intervention Requirements²⁶
 - Continuity of Contact Requirements²⁷
 - Duty to Comply with Loss Mitigation Procedures²⁸
- No duty to provide good faith estimate of settlement costs²⁹

Flood Insurance

- Servicers are not required to escrow for flood insurance (where required by the Flood Disaster Protection Act³⁰) for HELOCs.³¹

For more information, contact National Consumer Law Center Staff Attorney Andrew Pizor apizor@nclc.org or 202.452.6252 ext. 106.

²¹ Reg. X § 1024.31 (defining “mortgage loan” as “any federally related mortgage loan, as that term is defined in §1024.2 subject to the exemptions in §1024.5(b), but does not include open-end lines of credit (home equity plans).”).

²² Reg. X § 1024.33(b) and (c).

²³ Reg. X §§ 1024.35 and 1024.36.

²⁴ Reg. X § 1024.36(d).

²⁵ Reg. X § 1024.38.

²⁶ Reg. X § 1024.39.

²⁷ Reg. X § 1024.40.

²⁸ Reg. X § 1024.41.

²⁹ Reg. X § 1024.7(h) (exempting open-end loans).

³⁰ Pub. L. 93-234, 87 Stat. 975 (1973).

³¹ 42 U.S. Code § 4012a(d)(1).