

October 12, 2001

Alfred M. Pollard, Esq.
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, N.W.
Fourth Floor
Washington, D.C. 20552

Re: Proposed Flood Insurance Regulations, RIN 2550-AA21

██████████
Freddie
Mac

Dear Mr. Pollard:

Freddie Mac respectfully submits the following comments with respect to flood insurance regulations proposed by the Office of Federal Housing Enterprise Oversight (“OFHEO”) and published in the Federal Register on September 12, 2001.¹ Through these regulations, OFHEO proposes to reiterate the relevant statutory provisions specifically applicable to Freddie Mac and Fannie Mae (collectively, the “Enterprises”) and to codify them in OFHEO’s regulations.

I. Summary

Freddie Mac supports the National Flood Insurance Program (“NFIP”), particularly the role played by the Enterprises in requiring the maintenance of flood insurance by borrowers on improved properties located in special flood hazard areas. For the mortgage loans it purchases, Freddie Mac has implemented procedures reasonably designed to ensure that flood insurance is maintained on such properties, whether the properties are identified as being in special flood hazard areas at the time of loan origination or thereafter during the term of the mortgage.

Freddie Mac has consistently complied with all statutory requirements for flood insurance. In fact, as discussed below, Freddie Mac actually requires flood insurance in amounts that exceed the minimum statutory requirements.

Freddie Mac has been a leader in the mortgage industry with respect to flood insurance. Freddie Mac took a leading role in the Flood Insurance Interagency Task Force,² with Freddie Mac chairing the Federal Agencies Work Group. Freddie Mac also was an active member of the Technical Mapping Advisory Council.³ In industry conferences and forums sponsored by the Federal Emergency Management Agency (“FEMA”), Freddie

¹ 66 Fed. Reg. 47563.

² 42 U.S.C. § 4011 note.

³ 42 U.S.C. § 4101 note.

Mac has also taken a leadership position in the mortgage industry to support the NFIP. In 1995, a Freddie Mac employee, Al LeQuang, was awarded the inaugural Donald L. Collins Partnership Award by the Federal Insurance Administration for his work on behalf of Freddie Mac in supporting the NFIP.⁴

As required by the National Flood Insurance Reform Act of 1994 (“NFIRA”),⁵ Freddie Mac has “implemented procedures reasonably designed to ensure” compliance with its statutory obligations. This compliance was confirmed by OFHEO, based on its examinations of Freddie Mac, the results of which were included in OFHEO’s annual reports to Congress in 1996,⁶ 1998,⁷ and 2000.⁸

II. Comments and Recommendations

A. Amount of Flood Insurance Coverage

As proposed, 12 C.F.R. § 1773.2 reiterates 42 U.S.C. § 4012a(b)(3) with respect to the requirement on the Enterprises to implement procedures reasonably designed to ensure that for any loan secured by improved real estate or a mobile home in an area identified, at the time of loan origination or at any time during the loan term, by the Director of FEMA as an area having special flood hazards and in which flood insurance is available under the NFIP, and purchased by such Enterprise, the building or mobile home and any personal property securing the loan is covered by flood insurance. With respect to the amount of the required insurance, the proposed regulation also reiterates the statutory requirement that the amount of flood insurance be “at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage made available with respect to the particular type of property under the NFIP.”

Freddie Mac has implemented the requirements of the NFIRA by requiring flood insurance coverage levels at or above the statutory minimums. In the Single Family Seller/Service Guide, which is the contract between Freddie Mac and Seller/Service for mortgage loan purchases and servicing, Freddie Mac requires Seller/Service to ensure that borrowers maintain insurance “at least equal to the **higher**” of: a) 80% of the replacement cost of the insurable improvements, or b) the lower of the outstanding loan

⁴ “Mr. LeQuang is a longtime partner of the NFIP, and countless borrowers and lenders are protected by flood insurance as a result of his efforts in the secondary mortgage market.” FEMA Press Release, June 16, 1995.

⁵ 42 U.S.C. § 4001-4129.

⁶ OFHEO’s 1996 Annual Report to Congress, June 15, 1996, p. 54.

⁷ OFHEO’s 1998 Annual Report to Congress, June 15, 1998, p. 24.

⁸ OFHEO’s 2000 Annual Report to Congress, June 15, 2000, p. 76.

balance or the full replacement cost of the improvements (provided that the insurance never needs to exceed the maximum amount available under the NFIP).⁹

Freddie Mac requires such a potentially higher coverage amount because borrowers are not fully protected against a partial loss under an NFIP flood insurance policy if the policy covers less than 80% of the replacement cost of the improvements.¹⁰ Freddie Mac believes that the higher amount it requires serves the best interests of Freddie Mac, the borrower and the public purpose of the NFIP.

Recommendation

To avoid any doubt as to the authority of Freddie Mac to require such a higher coverage amount, Freddie Mac recommends that OFHEO add a provision to proposed § 1773.2(a) to ensure that nothing in the regulation precludes an Enterprise from requiring a higher level of coverage than is required by the regulation. Such a provision would also assist the Enterprises in the cases in which lenders or borrowers assert that a higher level of coverage may not be allowed under law.

B. Basis for Assessing Civil Money Penalties

OFHEO's statutory enforcement authority as to flood insurance is specifically targeted to imposing civil money penalties for patterns or practices of purchasing loans in violation of an Enterprise's procedures established pursuant to the NFIRA. The proposed regulation would exceed statutory limits to the extent that its language could be read to permit civil money penalties for other statutory or regulatory violations, or would permit enforcement actions other than civil money penalties.

⁹ Freddie Mac Single Family Seller/Service Guide, Volume 2, § 58.3(a) (emphasis in original).

¹⁰ FEMA expressly permits such coverage. The instructions in the NFIRA-mandated Standard Flood Hazard Determination Form clearly state "Lenders may exceed the minimum federal requirements." FEMA Form 81-93 (October 1998). Under FEMA's Mandatory Purchase of Flood Insurance Guidelines, FEMA states:

Although the Reform Act only requires the lender's interest to be protected by flood insurance, a lender may need to consider other factors, such as Fannie Mae and Freddie Mac requirements. Depending on the practice of the mortgagee, the policy may not be sufficient to protect the full equity amount held in the property by the mortgagor in the event of a loss. If the lender opts to protect only its security in the loan, the amount of the policy may be insufficient to cover the full insurable value of the property.

FEMA 186/May 1997, § C.2(h)(2).

Under § 1773.3(a) of the proposed regulations, OFHEO would reserve the right to assess civil monetary penalties¹¹ if the Director of OFHEO determines that an Enterprise engaged in a pattern or practice of purchasing loans “in violation of the procedures established pursuant to the NFIRA, as amended, or to § 1773.2” Proposed § 1773.1(a) discusses OFHEO’s authority to promulgate flood insurance regulations. “OFHEO [has] the authority to issue any regulations necessary to carry out the applicable provisions of NFIRA. OFHEO is also charged with enforcing the requirements of NFIRA as to the Enterprises and provides for the assessment of civil money penalties for violations of the procedures established by the Enterprises pursuant to the law or implementing regulations.”¹²

The statement in proposed § 1772.3(a) that OFHEO has authority to promulgate regulations “necessary” to carry out the NFIRA is apparently based on a general statutory statement about rulemaking authority.¹³ This general grant of authority to multiple agencies to promulgate “necessary” regulations does not override the NFIRA’s specific limitations on OFHEO’s authority to impose penalties.¹⁴

For example, OFHEO’s statutory authority to assess civil money penalties relating to flood insurance is targeted to assessing penalties for patterns or practices of purchasing loans in violation of an Enterprise’s procedures established pursuant to the NFIRA. OFHEO’s authority to assess penalties does not extend to violations of any OFHEO flood insurance regulation. Therefore, to the extent that a final flood insurance regulation were to impose requirements different than statutory requirements, OFHEO’s authority to impose penalties would not apply.

Similarly, OFHEO’s authority to impose penalties does not extend to any and all violations of the NFIRA, but is targeted only to a pattern or practice of purchasing loans in violation of procedures established pursuant to the NFIRA at 42 U.S.C. § 4012a(b)(3).

¹¹ In calculating the amount of the civil penalties, OFHEO adjusted the penalty amounts for inflation pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990. OFHEO calculated the adjustment to the penalties by calculating the difference in the CPI-U from 1994 to 2000. The difference for those years of 16.5% was limited, however, to the maximum statutory initial adjustment of 10%. It is noted for the record that the calculation should have been based on the initial adjustment year of 1995, rather than 1994, because the applicable statutory requirements on the Enterprises were not effective until September 22, 1995 (as noted in §1773.2(b) of OFHEO’s proposed regulations).

¹² Proposed § 1773.1(a).

¹³ “The Director of the Federal Management Agency and any appropriate Federal agency may each issue any regulations necessary to carry out the applicable provisions of this title and the applicable amendments made by this title.” Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 583, 108 Stat. 2160, 2287, codified in the NFIRA at 42 U.S.C. § 4001 note. This provision does not name OFHEO as the appropriate agency to promulgate regulations.

¹⁴ 42 U.S.C. § 4012a(f)(3).

Violations of other provisions of the NFIRA would not be a lawful basis for an assessment of OFHEO penalties.

Finally, the statement in proposed § 1773.1(a) that OFHEO is charged with enforcing the requirements of NFIRA “and” with assessing civil money penalties may be read to cover more than what the statute intended. The NFIRA establishes that its enforcement method, as to the Enterprises, is civil money penalty assessments, not other administrative actions. The statute does not extend OFHEO’s enforcement methods beyond civil money penalty assessments.¹⁵

Recommendation

For these reasons, Freddie Mac recommends that OFHEO modify proposed § 1773.1(a) to delete its final phrase “implementing regulations” to clarify that penalty assessments would not be based on violations of flood insurance regulations. Similarly, Freddie Mac recommends that in proposed § 1773.3(a) OFHEO replace the phrase “the NFIA, as amended, or to § 1773.2” with “42 U.S.C. § 4012a(b)(3).” These modifications would make clear that OFHEO would not assess civil money penalties for violations, or patterns and practices of violations, of any flood insurance regulation or of NFIA provisions other than § 4012a(b)(3).

Further, Freddie Mac recommends that OFHEO amend the statement in proposed § 1773.1(a) that “OFHEO is charged with enforcing the requirements of NFIRA as to the Enterprises and provides for the assessment of civil money penalty assessments” Instead, this should state that OFHEO is charged with enforcing the requirements of 42 U.S.C. § 4012a(b)(3) **through** assessment of civil money penalties. This would clarify that civil money penalties are the designated enforcement remedy as to the Enterprises.

¹⁵ Section 529(c) of the NFIRA required OFHEO to report to Congress three times over a six year period on the Enterprises’ compliance with 42 U.S.C. § 4012a(b)(3). Section 1319B of the Financial Safety and Soundness Act of 1992, 12 U.S.C. § 4521(a). OFHEO has made all three of those reports.

Alfred M. Pollard, Esq.
October 12, 2001
Page 6 of 6

III. Conclusion

Freddie Mac strongly supports the NFIP, and recognizes the responsibilities of the Enterprises, as well as regulated lenders, to support the important public policy reflected in the legislation. Freddie Mac has worked to ensure its compliance with the NFIRA, and recognizes the important role of OFHEO in ensuring compliance. Freddie Mac is confident that its record of compliance will continue under OFHEO's regulations.

Very truly yours,

Allan G. Ratner
Vice President and Deputy General Counsel