STATEMENT

Of

Regina M. Lowrie, CMB

On Behalf of the

Mortgage Bankers Association

At

The Hearing on

"Proposals to Reform the National Flood Insurance Program"

Before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

February 2, 2006

Good morning, Chairman Shelby, Ranking Member Sarbanes and Members of the Committee. Thank you for inviting the Mortgage Bankers Association (MBA)[1] to testify today. My name is Regina Lowrie and I am President and Founder of Gateway Funding Diversified Financial Services, headquartered in Fort Washington, Pennsylvania. I founded Gateway in 1994 with seven employees and $1.5 million in startup capital. The company now has more than 800 employees, more than 58 offices and is Greater Philadelphia's largest independent mortgage company, serving all of Pennsylvania, Delaware, New Jersey and Maryland. Gateway annually originates $3 billion in loans. I serve on the Fannie Mae National Advisory Council, the Pennsylvania Housing Forum, and the Montgomery County Community College Foundation Board of Directors. I am here today as the 2006 Chairman of the Mortgage Bankers Association.

Over the years, the nationwide availability of affordable flood insurance has been important to expanding homeownership and building communities. The National Flood Insurance Program (NFIP) serves a very important function in the mortgage lending industry as it reduces the overall cost of financing a property located in a flood prone area by providing affordable and reliable flood insurance. Even before the statutory mandatory purchase requirement was enacted, lenders often required flood insurance to protect their collateral interests. With the passage of the Flood Disaster Protection Act of 1973, however, it became unlawful to make, increase, extend or renew a loan secured by a structure located in a Special Flood Hazard Area (SFHA) without flood insurance coverage for the life of the loan. Without a reliable and uninterrupted source of flood insurance, we believe mortgage credit would, at best - be more expensive, or at worst - unavailable in many markets.

Although there are private providers of flood insurance, MBA estimates that 90% of all residential flood policies are written through the National Flood Insurance Program (NFIP). The mortgage industry wants to ensure the continued viability of the NFIP. At the same time, overly expansive extension of the flood insurance requirements could have unintended consequences, increasing the costs of homeownership, affordable rental housing, and occupancy costs for

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 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 3,000 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.

businesses. It could also increase delinquencies and foreclosures, increase business failures and reduce property values.

Another unintended consequence of a further expansion of the NFIP is the impact on state-regulated life insurance companies that include commercial and multifamily loans in their overall investment portfolio used to pay policyholders. The National Flood Insurance Reform Act of 1994 (NFIRA) did not address loans made by non-federally chartered lending institutions. Life companies are regulated by state insurance commissioners. The mandatory inclusion of life company loans in the NFIP would preempt state regulatory authority for life companies. If expansion of the law is being considered to include state-licensed companies, such a preemption should be carefully considered, given the historic role that states have played in the regulation of life companies and other mortgage lenders and servicers.

Reform of the flood insurance program should be exercised with caution and full awareness of the implications of any actions. We do not believe there is a quick fix.

The unprecedented number of natural disasters last year placed the NFIP in a deficit. Currently, it is estimated that total claims will top $23 billion for 2005. The NFIP has already borrowed $18.5 billion from the Treasury and will need an additional $5.6 billion in borrowing authority to pay current outstanding claimants. Of course, the largest contributing factor to this financial situation is Hurricane Katrina, which alone resulted in nearly $22 billion in claims. The number one priority must be to ensure that NFIP has sufficient funds to pay outstanding claims. We, therefore, urge Congress to provide the additional borrowing authority NFIP will need to pay claims that are due to policyholders.

We would also like to take this opportunity to discuss reforms currently being mentioned, including expanding the scope of the mandatory purchase of flood insurance requirement to the 500-year floodplain and removing current premium subsidies.

Expanding the Special Flood Hazard Area

In November of last year, the House Financial Services Committee reported out H.R. 4320 by voice vote. Among other things, this bill requires a study of increasing the size of the Special Flood Hazard Area (SFHA) to the 500-year floodplain and areas that would have such a chance of flooding "but for the existence of a structural flood protection system." At this time, MBA does not support expanding the Special Flood Hazard Area to include the 500-year floodplain. MBA believes further study is necessary before expanding the Special Flood Hazard Area designation and the mandatory purchase requirement to the 500-year floodplain.

Based on preliminary analysis, MBA estimates that approximately three to four million properties[2] are located in the 500-year floodplain and, thus, the scope of the mandatory purchase requirement would increase substantially. Of course, not all properties are subject to the mandatory purchase requirement. In fact, approximately 35% of homeowners do not have a mortgage[3] and thus cannot be required to purchase insurance under current law.

It is unclear without further study, what such an expansion would do to housing affordability, home retention, commercial and multifamily property values, small businesses and regional markets.

A concern with moving to a 500-year floodplain is the fact that some maps do not currently indicate the 0.2% risk (1 in 500 year occurrence). Because community mitigation, building codes and mandatory purchase requirements are tied to the 100-year floodplain, some maps fail to reflect the 500-year designation; therefore, significant map adjustments may be required.

There are other unanswered questions associated with expanding the SFHA designation that deserve further investigation, such as whether including the 500-year floodplain within the SFHA designation will trigger unintended building standards and higher premiums that will drive up the cost of homeownership and home retention, as well as commercial development and operating costs.

As mentioned earlier, H.R. 4320 calls for such a study and we believe it should be conducted before any action is taken. We believe, however, that special attention should be given to the feasibility and implications of expanding the mandatory purchase requirements on structures located in areas of residual risk, that is, properties behind levees, dams, and other man-made structures. MBA is aware that many properties in the New Orleans area, for example, did not have flood insurance because the presence of the man-made levees reduced the annual risk below 1% (100-year floodplain). Yet, it was the inadequacy of the levees and not the immediate impact of the hurricane that caused the flood damage.

There also should be evidence that the standard flood insurance policy would cover the type of damage likely to be experienced by the property owners in the newly expanded SFHA. For example, given that structures in a 500-year floodplain are not subject to the same elevation concerns, many properties have basements. The NFIP policy, however, excludes finished basements, where flooding would most likely occur in these cases.

Increasing Premiums/Reducing Subsidies

[2] Information compiled by MBA from flood determination companies.
[3] MBA's "Housing and Mortgage Markets: An Analysis" (using the Census Bureau's American Housing Survey), September 2005

In testimony before this Committee last week, NFIP's Acting Director for Mitigation suggested phasing out subsidized premiums in order to charge policyholders more market-oriented actuarially sound premiums.

There are two basic forms of rate subsidies offered to property owners under the NFIP. The first is given to so-called pre-FIRM structures – that is structures built prior to the completion of the flood insurance rate maps (FIRM). They are generally older housing stock. The other form of subsidy is the "administrative grandfather." In this case, post-FIRM structures that are remapped into a SFHA or subject to base-flood elevation changes are allowed to retain the rates associated with the property's former designation. These policies were put in place to avoid undue financial burden on property owners who complied with construction codes and flood information when their structures were built.

Now that the NFIP has had to borrow substantial funds from the Treasury, the thought of an actuarial rate structure is attractive, but the reality may be problematic. Last week the Acting Director of the Congressional Budget Office (CBO) indicated that nearly 25% of policyholders receive subsidized rates. He indicated that if subsidies were removed, the average policy cost on a pre-FIRM structure would go from $710 to $1,800 a year. There are many individual cases where the rates would be significantly higher. For example, a pre-FIRM structure with total flood coverage of $150,000 is currently subject to a pre-FIRM premium of $590 a year. The same property, if subject to the full post-FIRM actuarial rate structure, would incur an annual premium of $2,200 if the lowest floor were two feet below base flood elevation; $5,875 if the floor were five feet below base flood elevation; and $17,050 if the floor were eight feet below the base flood elevation.[4]

Moving to a fully actuarial premium structure could have a significant impact on Hurricanes Katrina and Rita victims who wish to remain or return to the Gulf area. NFIP's remapping efforts in the Gulf are underway and are expected to result in increased base flood elevations in several Louisiana coastal parishes and portions of Mississippi. Base flood elevation levels for certain parishes in Louisiana may rise one to nine feet based on flood frequency analysis conducted by the Federal Emergency Management Administration (FEMA).[5] Under a true actuarial scheme, many homeowners and commercial property owners who are unable to raise their properties to the base flood elevation could find it financially impossible to retain or repair their structures. These properties could be rendered unmarketable. Defaults and foreclosures would mount further. Given the "unmarketable" nature of the properties, homeowners, commercial property owners and lenders would bear the cost of the government's change in policy. For commercial properties, the cost of raising the occupied floor level to the mandated base flood elevation could render the property economically infeasible. Additionally, parking ingress and egress issues would be created by significantly elevating the occupied portion of the commercial structure.

[4] Data provided by FEMA based on 2003 rates
[5] FEMA's Flood Recovery Guidance, Frequently Asked Questions (Dec. 1, 2005)

In 1999, FEMA commissioned a study of the impact of charging actuarial rates on pre-FIRM structures. As can be expected, this independent study by PriceWaterhouseCoopers,[6] shows that certain communities would fare worse than others. Of significance in that study, is a finding that the most severely affected communities could see a 10-32% loss in home values.[7] Such a reduction would have a dramatic impact on the local tax base; affecting the funding of education and emergency services. Additionally, household wealth formation in these communities would be dramatically impacted. These negative impacts would reverberate throughout the economic base of a community.

One of the key benefits of a government flood insurance program is to provide affordable insurance coverage to all property owners in participating communities. Clearly a number of homeowners and commercial property owners with older structures would be severely impacted by a change in rates through no fault of their own. We, therefore, respectfully urge Congress to further study the consequences before making a decision to move to a fully actuarial premium structure. MBA does not support such a concept at this time.

MBA, however, does support an increase in the annual premium cap. Today, FEMA is permitted to increase premiums by 10% per annum. We support allowing an increase in premiums of 15% per year.

There have been several attempts to deal with the problem of repetitive loss properties. MBA believes the best way to deal with repetitive loss properties is through the existing mitigation programs and to implement the programs passed into law in 2004. To the extent that properties with subsidized rates are producing significant losses for the NFIP, which we expect some do, the homes should be eligible for buy-out or elevation changes.

Lender Compliance

Mortgage lenders have been the only enforcers of the mandatory purchase requirements since enactment of the Flood Disaster Protection Act of 1973 (PL 93-234). The 1973 Act, for the first time, restricted federally insured depository institutions from making loans in a Special Flood Hazard Area without flood insurance. It also prohibited federal agencies, such as the Federal Housing Administration and the Department of Veterans Affairs, from providing financial assistance for acquisition or construction purposes. [8]

The National Flood Insurance Reform Act of 1994 (NFIRA) expanded the mandatory purchase requirement to loans purchased by Fannie Mae or Freddie

[6] Executive Summary, "Study of the Economic Effects of Charging Actuarially Based Premium Rates for Pre-FIRM Structures," PricewaterhouseCoopers (May 14, 1999)
[7] Id at 20.
[8] Federal Insurance Administration (FIA) notice 1978b stated that federal financial assistance includes "loans, guarantees, and similar forms of direct and indirect assistance from Federal agencies." 43 Fed Reg 7140-41

Mac. Both Fannie Mae and Freddie Mac, however, already required the purchase of flood insurance at the time of enactment of NFIRA. NFIRA also re-affirmed the lender's obligation to keep the policy obtained at origination in force for the life of the loan through the use of lender-placed insurance, if necessary.

We are very concerned, with certain remarks made last week before this Committee. During questioning, the NFIP Acting Director of Mitigation indicated in response to questioning that he believed the level of non-compliance with the mandatory purchase requirement was between 40-60%. We recognize the comments were made without the benefit of data before the witness, and, thus, would like to take this opportunity to comment on lender compliance.

As an industry, mortgage companies execute the flood insurance obligations consistently, in good faith, and with few errors. In fact, an independent study produced for FEMA by the American Institutes for Research (AIR) in March of 2005[9] shows significant compliance with the law. Of relevance to the mortgage industry, the study interviewed representatives from Fannie Mae, Freddie Mac, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) to determine the level of compliance.

In the study, Fannie Mae indicates that it "finds high compliance with the mandatory purchase requirements among its seller/servicers. It infrequently encounters a loan that does not have flood insurance when it is supposed to, and it does not often detect a pattern of noncompliance or any systemic issues related to noncompliance with the requirement."[10] The study also interviewed Freddie Mac representatives and found that "when it [Freddie Mac] does find non-compliance, however, it is usually the lenders' failure to provide proof of insurance, and they [the lenders] typically address the problem."[11]

The bank regulators had similar findings. The FDIC which supervises and examines 5,300 banks and savings institutions, or more than half of all the financial institutions in the United States, imposed 58 civil money penalties (CMP) between 2001 and 2004 for a pattern or practice of violating the Flood Disaster Protection Act. The majority of these infractions, or 70%, were for $5,000 or less, indicating that non-compliant institutions had only a handful of violations when they had them at all. The Federal Reserve Board imposed 20 CMPs in 2004. The OTS issued five CMPs between 2001 and 2004 and the OCC assessed 11 CMPs as of December 2004.[12]

The NFIRA is a complicated law with a multitude of requirements including the requirement to: notify NFIP's designee when servicing is transferred; notify the borrower when the property is deemed to be located in a SFHA; mandate the

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[9] "The National Flood Insurance Program's Mandatory Purchase Requirement: Policies Processes, and Stakeholders," American Institutes for Research, (March 2005)
[10] Id at 84.
[11] Id at 85.
[12] Id at 69-79.

purchase of insurance and place such insurance on the borrower's behalf when necessary – to name a few. Our members have instituted significant procedures to ensure compliance with these and other statutory obligations. It is, however, important to note that despite a high level of due diligence, human error cannot be completely eliminated in a complex compliance setting such as the statutory flood insurance requirements.

At this time, I would like to describe what servicers do to ensure that flood insurance is obtained where required and stays in force.

At origination, the lender will request a flood determination on every loan in its pipeline. That means sending a request to a specialty flood determination company to read the flood maps to determine if a particular structure is in a SFHA.

If the property is located in an SFHA, the lender will notify the borrower of the SFHA designation, require him or her to purchase flood insurance and require evidence of such insurance before closing. The first year's premium is paid up front, prior to closing.

After the loan closing, the servicer enters information into its computer system indicating the flood zone designation associated with the structure, if the loan is subject to the mandatory purchase requirement, the policy expiration date and other pertinent policy information. At that time, the servicer reviews the insurance policy to make sure that the servicer's name is listed as the "mortgagee/loss payee." This ensures that future billing notices and insurance claim checks will be sent to the right servicer.

On escrowed loans, the servicer will pay the insurance premium based on the expiration date in the system and the renewal billing sent to the servicer by the insurer. This is monitored closely. To protect against the occasional non-receipt of renewal notices, servicers produce weekly or monthly reports that alert them to upcoming expiration dates of both hazard and flood insurance policies.

Even if a loan is not escrowed, the insurer will normally send the servicer a notice of policy renewal when a premium is paid. Servicers track the expiration date of the policy and the receipt of the renewal notices. If a notice of policy renewal is not obtained from the insurer, the servicer will notify the property owner that a policy renewal has not been received, as required by the terms of the mortgage agreement, and if not provided, will result in the lender obtaining adequate insurance on the borrower's behalf. Generally two notices are sent to the borrower within 45 days after the expiration date of the policy before the servicer imposes lender-placed insurance. These notices also generally point out that lender-placed coverage is often more expensive and may provide less coverage than a borrower-placed policy.

Finally, if the borrower cancels the flood insurance policy, the insurer is required by contract to notify the lender -- as mortgagee/loss payee – of the cancellation. This cancellation notice occurs regardless of whether the premiums are escrowed. It is important to note, that in many cases, cancellations are due to a borrower's change in insurance carrier. If a cancellation notice is received and the borrower has not otherwise notified the servicer of a change in insurance carrier and provided proof of insurance, the lender will send the notices described above warning the borrower that if he or she does not provide proof of insurance in 45 days, the lender will impose lender-placed coverage.

Again, if the lender does not receive proof of insurance by the date specified in the letter, a flood insurance policy is purchased by the lender and charged to the borrower. The servicer also notifies the borrower when it has obtained lender-placed coverage. Should the borrower subsequently provide proof of insurance and no lapse in coverage has occurred, the premiums are returned to the borrower in full.

Lender-placed insurance policies are generally obtained through private insurers, not from the NFIP's forced placed program, the Mortgage Portfolio Protection Program (MPPP). This is because the MPPP policy is effective on the date the application is completed and the premium is paid. Because NFIRA prohibits lenders from force-placing insurance for 45 days from borrower notification, there is generally a 30-day gap in insurance coverage under the MPPP. Conversely, private lender-placed policies are effective as of the expiration date of the policy and thus eliminate this gap. We believe that part of FEMA's stated concern over their retention rate is due to this factor. FEMA loses almost every lender-placed policy to the private insurance market.

In addition to the regular monitoring mentioned above, servicers also perform periodic review to make sure, for example, that properties with high risk A and V flood designations (i.e., SFHA designations) are covered by insurance. If specific investors require additional monitoring, as is the case with Fannie Mae and Freddie, that is performed as well.

Opposition to Expanding the Triggering Events/Requiring On-going Map Monitoring

Servicers vigorously comply with the law to ensure that flood insurance when required at the time of origination does not lapse or get cancelled after closing. Unfortunately, discussion has surfaced once again about requiring on-going monitoring of all loans that are not in SFHAs at origination to determine if they later get remapped into an SFHA. If the law is expanded to require on-going map monitoring or adds remapping as a triggering event for the mandatory purchase requirement, residential and commercial lenders will face increased administrative, liability and enforcement issues.

Collectively, the top five commercial servicers service over 120,000 loans, residential loan servicers service over 52 million loans.[13] If on-going map monitoring is required, the servicer will be required to review each loan and every insurance policy on existing mortgages that may be in an affected (remapped) area to ensure compliance with the legislation. There is a heavy administrative cost associated with this type of review and, when coupled with the potential increase in penalties imposed on lenders/servicers that do not enforce the legislation, the requirement is unduly burdensome.

In addition, on existing mortgages, there may be issues with increased contract liability and the servicer's right to enforce the revised flood plains or mandatory insurance requirements. As soon as the requirement would become law, the lender/servicer becomes subject to contractual liability, based on its relationship with investors and other transactional parties, for non-enforcement of revisions to the legislation. At the same time, the servicer may not be able to enforce the revisions with borrowers based on their contractual language. For example, some commercial loan contracts do not permit the servicer to add insurance coverage that was not contemplated originally. This very issue prompted several lawsuits after September 11, with respect to terrorism insurance. This creates a gap between what the servicer can contractually obtain from the borrower and what the servicer is statutorily obligated to do.

MBA opposes any requirement that would expand the current triggering events for the mandatory purchase requirement from the making, increasing, extending and renewing of a loan. Otherwise stated, we oppose expanding the triggering events to include publication of a map revision and we oppose on-going map monitoring.

Potential Reforms

We believe there are several reforms that NFIP should consider that will help increase its market penetration and revenues. These recommendations are based on the existing statutes and presume no increase in the scope of coverage of the law. Of course, each one of these suggestions carries some level of risk and potential costs that must be weighed by the benefits of additional premium income. We would like to address each one in turn:

> Provide Additional Funding for Map Modernization – It is crucial for the NFIP to have the most up-to-date maps to mitigate hazards and more completely determine the risks to homeowners and property owners. Every year, flooding occurs in areas outside of designated flood plains. The federal government should to ensure sufficient funding for this activity.
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> Consider Increasing Deductibles – Under the current program, the lowest deductible for structures and contents is $500, and we believe this could

[13] MBA Research Department

be increased to $1,000 for single-family residential and up to 5% for five or more unit multifamily properties. Increasing the minimum deductible could have many positive effects. First, it would help to increase capacity to write additional insurance. Second, by increasing the share of the risk that the policyholder assumes, there would be a greater incentive for the policyholder to engage in mitigation efforts. Third, higher deductibles would help keep premiums more affordable.

Reclassify Multifamily Properties - Increase the maximum structural coverage for multifamily properties (apartment buildings) to $500,000 adjusted annually for inflation and increase the maximum content coverage to $500,000, also adjusted for inflation.

Increase Coverage Limits – Increase maximum residential coverage from $250,000 to a level based on the rate of inflation since 1994. Increase the content coverage from $100,000 for residential to a level more consistent with inflation. The NFIP maximum limits have not been increased since 1994, yet labor and materials costs have increased significantly since that time.

Consider Creating a "Deluxe" Flood Insurance Policy – For an extra premium, the policy could include the following optional features: (1) alternative living expense coverage, set at a percentage of the structure limits, including lost rental income for residential, commercial and multifamily rental properties; (2) mortgage assistance payments; (3) replacement cost coverage for personal property; and (4) basement coverage. Some consumers believe that the current flood policy does not provide meaningful coverage. The policy would also cover losses associated when civil authority declarations that prevent the use or occupancy of a property even though it may have not been directly impacted by flooding.

Inclusion of Deadlines for FEMA Responsibilities under 2004 Reform Act – This includes the appeals process; minimum training and education requirement; mitigation programs and a report to Congress on the implementation on the 2004 reform bill.

Conclusion

There is clearly no easy recipe to ensure the NFIP brings in sufficient premiums to cover the federal outlay of funds used to pay claims without affecting a home or business owner in another part of the country. But there are clearly things that can be done and should be done to improve the program, including increasing maximum policy coverage. As a representative of the mortgage industry, I also want to assure you that lenders take very seriously their compliance with the flood laws and do what is in our power to ensure compliance. As a result, we would oppose increased sanctions on the industry or expanding lender

obligations. In sum, MBA believes it is crucial that Congress move quickly to increase the borrowing authority in order for the program to continue to meet its obligations to current policy holders and claimants in the affected Gulf Region.

Thank you for allowing MBA the opportunity to share the industry's views with the Committee.