MONITORING OF INSURANCE COVERAGE FOR DISASTER LOAN RECIPIENTS

Report Number: 10-01

Date Issued: October 20, 2009

U.S. Small Business Administration
Office Inspector General

Memorandum

To: John A. Miller
Director, Office of Financial Program Operations

Date: October 20, 2009

/s/ Original Signed

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Report on the Monitoring of Insurance Coverage for Disaster Loan Recipients, Report No. 10-01

This report summarizes our audit of the Small Business Administration's (SBA) monitoring of insurance coverage for disaster loan recipients. The audit was designed to determine whether the SBA disaster loan servicing centers adequately monitored the coverage of required insurance policies on collateral properties in the disaster loan servicing portfolio, as required by Agency policy and Federal law. Specifically, the audit objectives were to evaluate whether the disaster loan servicing centers have (1) ensured that required insurance policies provide adequate coverage and are continuously renewed, and (2) taken action to obtain required flood insurance policies for borrowers who have not maintained them.

To assess the Agency's monitoring of insurance coverage, we focused our analysis on 23,068 fully disbursed disaster loans that resulted from the 2005 Hurricanes Katrina, Rita, and Wilma, the 2008 Hurricanes Ike and Gustav, and the 2008 Midwest floods. From this total population of loans, we obtained a statistical sample of 120 collateralized loans that required flood and hazard insurance coverage until maturity. To test whether the required insurance coverage was current on the sampled collateral properties, we reviewed Disaster Credit Management System (DCMS) entries, information in the Centralized Loan Chronology System (CLCS), and physical collateral files associated with each sampled loan to identify the insurance company that initially provided coverage. We then contacted the insurance companies to determine whether the required flood and/or hazard insurance policies were current. Our audit scope and methodology is further detailed in Appendix I, and our sampling methodology is provided in Appendix II.

We conducted the audit between March 2009 and June 2009 in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

We found that SBA did not ensure that borrower insurance policies provided adequate coverage and were continuously renewed. The Agency also did not comply with statutory requirements to purchase policies for borrowers who let their policies lapse. As a result, we identified $3.8 million in outstanding loan balances that may not be adequately protected.[1] Projecting our sample results to the universe of 23,068 loans, we estimate that at least 5,341 loans, with approximately $510 million in outstanding loan balances, lacked evidence of adequate protection by current insurance coverage. Although our review focused on loans resulting from several specific disasters, we expect that a similar rate of unprotected loan balances exists for loans resulting from other major disasters.

We are recommending that SBA inform borrowers on the loans we identified with lapsed policies or insufficient insurance coverage that they must provide evidence of adequate insurance coverage. We are also recommending that SBA determine the actions needed to achieve compliance with statutory flood insurance requirements and the cost implications of achieving compliance. If SBA determines that it is not cost effective to purchase insurance for borrowers who refuse to renew their policies, then it should take steps to seek additional funding or a legislative change to this requirement. We are also recommending that SBA clarify in its operating procedures what actions should be taken when borrowers do not obtain hazard insurance, which Agency policy requires.

BACKGROUND

The National Flood Insurance Act of 1968, combined with the Flood Disaster Protection Act of 1973, states that no Federal agency lenders may extend a loan secured by real estate that is located in a "Special Hazard Flood Area" unless that real estate is covered for the term of the loan by flood insurance. The amount of coverage must be at least equal to the outstanding balance of the loan, or the maximum limit of coverage available, whichever is less. Through its national flood mapping efforts, the Federal Emergency Management Agency determines what areas of the country constitute a Special Hazard Flood Area. The 1973 Act further states that if a Federal agency lender determines that a borrower has failed to maintain adequate flood insurance coverage, the agency must instruct the borrower to obtain the required coverage. If the borrower fails to purchase the required insurance coverage within 45 days of the notification, the agency must

[1] In responding to the draft report, SBA determined that some of the borrowers flagged by the audit as lacking evidence of insurance did have the required insurance coverage.

purchase the insurance on behalf of the borrower, and charge the borrower for any associated costs.

SBA's Disaster Loan Servicing Standard Operating Procedure (SOP) 50-52 contains flood and hazard insurance monitoring requirements for use in the servicing of disaster loans. The flood insurance requirements mirror those listed in the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973. Although no applicable Federal requirements regarding hazard insurance exist, SOP 50-52 states that borrowers must maintain hazard insurance coverage in accordance with their Loan Authorization and Agreements. In contrast to the procedures regarding flood insurance, the agency will not purchase or maintain hazard insurance on property securing a loan as a general policy. SOP 50-52 does not indicate what actions should be taken when a borrower fails to maintain the required hazard insurance.

During the disaster loan origination process, loan officers at SBA's Processing and Distribution Center (PDC) are required to ensure that borrowers have purchased all required flood and hazard insurance coverage on collateral properties before fully disbursing a loan. These initial insurance policies typically last 12 months, and must be renewed by borrowers on a yearly basis. Once a loan is fully disbursed, the loan file is transferred to either the Birmingham or El Paso Disaster Loan Servicing Center, where all servicing actions occur throughout the life of the loan. After a loan is transferred to a servicing center, servicing personnel are responsible for monitoring all required insurance coverage.

RESULTS

Our review of 120 collateralized, fully-disbursed loans identified 35[2] that lacked evidence of the required flood and/or hazard insurance coverage, and an additional loan that lacked adequate hazard insurance coverage. Of the 35 loans without evidence of insurance, 19 lacked evidence of hazard insurance, 5 lacked evidence of flood insurance, and 11 lacked evidence of both. SBA made no attempt to notify borrowers to obtain insurance, and when none was obtained, to purchase flood insurance for non-compliant borrowers located in Special Hazard Flood Areas. Projecting these results to the universe of loans sampled, we estimate that at least 5,341 disaster loans, with approximately $510 million in outstanding balances, lacked evidence of adequate insurance coverage on collateral properties. Although our testing of insurance coverage was limited to loans resulting from several specific disasters, we expect that similar non-compliance rates may exist for loans associated with other major disasters.

[2] After the draft report was issued, SBA determined that 17 of the 35 borrowers had the required insurance coverage.

OFA management indicated that the servicing centers discontinued all insurance monitoring activities 23 years ago. The centers do not track insurance coverage on collateral properties or enforce insurance requirements on non-compliant borrowers, and policy documents provided by insurance providers are discarded without being reviewed. During a site visit to the El Paso Disaster Loan Servicing Center, we identified hundreds of insurance documents that were about to be discarded. One particular box contained: 420 renewal policies, 106 notices that current policies would soon expire, 87 cancellation notices, 40 notices indicating that coverage had expired, 31 amended policy declarations, and 13 miscellaneous documents.

The decision to not monitor insurance coverage was based on a 1986 Agency memo[3] that allowed insurance monitoring activities to be suspended during periods of high workloads and low staffing levels. The memo stated, "… when manpower or volume is a problem, we do not require any follow-up on flood insurance or any extended pursuit of hazard insurance when a cancellation is received." The memo additionally instructed that insurance documents should not be maintained in loan files, and that insurance companies should be instructed to not provide SBA with policy declarations or notices. This guidance conflicts with the Flood Disaster Protection Act and SOP-50-52, which require that flood insurance policies be purchased for non-compliant borrowers with collateral properties located in Special Hazard Flood Areas.

The Agency faces several challenges in complying with Federal and SOP requirements for insurance monitoring because the servicing centers do not have a centralized database listing collateral or insurance requirements for the disaster loan servicing portfolio. To implement the insurance monitoring requirements of SOP-50-52, center staff would have to search multiple data sources to associate it with the correct loan file and take appropriate action. For example, loan servicing staff would first have to access DCMS to obtain the most recent Loan Authorization and Agreement, and review the applicable *Collateral, Stipulation,* and *Property* screens to determine the required coverage amounts. However, this information is only current as of the date the loan was fully disbursed. The servicing staff must then review CLCS to determine if any subsequent changes were made to the collateral or insurance requirements at the loan servicing center. Amendments to the loan terms would then be located in the loan's collateral file. This approach does not provide the Agency with an efficient method of monitoring yearly insurance policy renewals.

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[3] A copy of the Agency memo is provided in Appendix IV.

Additionally, SBA does not receive all cancellation notices from insurance providers because insurance companies do not always properly list SBA as a lien holder on the policy declarations. Therefore, it would not know when some required insurance policies expire. For example, SBA was not properly listed as the lien holder on required insurance policies for 31, or 26 percent, of the 120 sampled loans. When SBA is not listed as a lien holder, policy documents, such as cancellation and renewal notices are not provided to the Agency.

To effectively monitor and enforce insurance requirements on the loan servicing portfolio, SBA needs a centralized database that lists each loan's collateral properties and associated insurance coverage. Also, policy numbers, coverage amounts, and coverage dates should be recorded, and the information from cancellation or renewal notices should be continuously updated in the system. When a policy's expiration date has passed, an alert can be sent to loan servicing personnel, instructing them to contact the insurance provider or the borrower for evidence of a renewal. This capability would require either a modification of DCMS or development of an insurance monitoring system, which may be costly.

Finally, a process where loan servicing staff must contact insurance providers upon expiration of the insurance policy would also ensure that SBA does not overlook any loans for which it is not listed as a lien holder on the policy declaration. Such a system should interface with DCMS for collateral property addresses and insurance policy data, and the insurance policy details could be edited by servicing personnel with appropriate user access.

Because significant costs may be involved to execute the insurance monitoring requirements of the National Insurance Flood Act, SBA will need to determine the cost effectiveness of complying with the statute, and if determined to be too costly, take steps to seek additional funding or a change in the statute.

RECOMMENDATIONS

We recommend that the Director of the Office of Financial Program Operations:

1. Inform borrowers on the 36 loans with lapsed policies or insufficient coverage that they must provide evidence of adequate insurance coverage.

2. Determine the actions needed to achieve compliance with statutory flood insurance monitoring requirements and the cost implications of achieving compliance.

3. Develop and execute a plan for achieving compliance on existing and future loans. Alternatively, if achieving compliance is determined to be not cost

effective, seek additional funding or a legislative change to the statutory flood insurance requirement.

4. Revise SOP 50-52 to clarify what action(s) servicing center personnel should take when borrowers refuse to obtain required hazard insurance.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On August 10, 2009 we provided the Office of Financial Assistance (OFA) with the draft report for comment. On October 13, 2009 OFA submitted its formal response, which is contained in Appendix V. Management agreed with our findings, partially concurred with Recommendations 1 and 2, has initiated action to address Recommendation 1, and concurred with Recommendations 3 and 4. A summary of management's comments and our response follows.

Recommendation 1

Management Comments

OFA has contacted or attempted to contact all 36 borrowers we identified as potentially lacking flood and/or hazard insurance. The Agency found that 17 of the borrowers do have the required insurance coverage in place, 9 do not have the required coverage in place, and 10 could not be contacted. On 8 of the 19 loans where borrowers either lacked the required insurance coverage or were unreachable, SBA holds a first lien position on the collateral property. OFA has agreed to put their emphasis on these eight loans and attempt to obtain the required insurance coverage.

OIG Response

Management's comments are partially responsive to the recommendation. Although the proposed action to address the eight loans in which SBA is the first lien holder should be a priority, we believe that the remaining 11 loans in which SBA is not the first lien holder need to be addressed as well. Because OFA has already determined that 19 of the 36 loans we identified may lack the required insurance coverage, the Agency should work to remedy all 19 loans without prejudice. We see no reason to exclude loans in which SBA is not the first lien holder when the deficiencies have already been identified or to exclude the 10 borrowers that could not be contacted. Consequently, we will pursue a management decision on this recommendation through the audit resolution process. SBA also needs to provide a target date for actions proposed on the eight loans.

Recommendation 2

Management Comments

In order to manage the high volume of loans in the servicing portfolio that require insurance monitoring, management decided to limit its flood insurance monitoring actions to only address higher risk loans where collateral property is located in a Special Flood Hazard Area, and SBA is the first lien holder on the collateral property. This decision is based on the position that SBA holds little to no equity in properties for which it is not the first lien holder, and that the first lien holders should bear the responsibility of enforcing flood insurance requirements on the borrowers. Management has agreed to enforce the flood insurance requirements as prescribed in the Flood Act on loans in which SBA is the first lien holder on collateral property, and the collateral is located in a Special Flood Hazard Area. Management also plans to query all disaster loans made since the establishment of DCMS in 2005 to identify all loans for which SBA is the first lien holder on real estate securing the disaster loans.

OIG Response

Management's comments are partially responsive to the recommendation. We acknowledge that the task of enforcing the requirements of the Flood Act on the entire loan servicing portfolio is extensive and believe that enforcing the flood insurance requirements where SBA holds a first lien position on the collateral property on is a good starting point. However, unless SBA has a legal opinion, which concludes that the requirements of the Flood Act are satisfied by monitoring only those loans for which it has a first lien holder position, we believe it should contact the first lien holders to ensure the insurance requirements have been enforced. Because SBA will need to discuss the legislative requirements with the appropriate parties to determine whether its planned actions are sufficient to fulfill the requirements of the Flood Act, we do not consider management's actions to be fully responsive to the recommendation. Therefore, we will pursue a management decision through the audit resolution process.

Recommendation 3

Management Comments

Management stated that it will initiate a 6-month trial project in which disaster loan servicing staff will monitor whether borrowers are maintaining required flood insurance coverage, and will purchase flood insurance for borrowers that refuse to comply with insurance requirements. This action will be limited to addressing loans for which SBA is the first lien holder on collateral property. Upon completion of the trial project, management will evaluate the results and determine what insurance monitoring procedures will become permanent Agency policy.

OIG Response

Management's comments are responsive to the recommendation. However, to prevent an unnecessary disruption, we believe that flood insurance monitoring actions should be continued while the results of the trial project are being evaluated.

Recommendation 4

Management Comments

OFA indicated that it would follow-up with borrowers that are associated with loans where SBA has a first lien holder position on collateral property to remind them of their hazard insurance requirements. Disaster loan servicing personnel will explain to non-compliant borrowers that SBA has the right to purchase hazard insurance coverage on collateral property, and that no further assistance will be provided until evidence of the required hazard insurance is submitted. This guidance will be added to SOP 50 52 in 2010.

OIG Response

Management's comments are responsive to the recommendation.

ACTIONS REQUIRED

We request that the ODA provide a target date for implementing proposed actions on recommendation 1 by October 30, 2009. We appreciate the courtesies and cooperation of the Office of Financial Assistance. If you have any questions regarding this report, please contact Craig Hickok, Director, Disaster Assistance Group, at (817) 684-[FOIA ex. 2]

APPENDIX I. SCOPE AND METHODOLOGY

The audit objectives were to evaluate whether the Disaster Loan Servicing Centers have (1) ensured that required insurance policies provide adequate coverage and are continuously renewed and (2) taken action to obtain required flood insurance policies for borrowers who have not maintained them.

To satisfy these objectives, we interviewed managers at the El Paso and Birmingham Disaster Loan Servicing Centers regarding the insurance monitoring procedures that the centers were following, and to determine whether flood insurance policies have been purchased for non-compliant borrowers. We reviewed a statistical sample of 120 collateralized disaster loans that had been fully-disbursed between January 1, 2006 and December 31, 2008 to test whether all flood and/or hazard insurance policies required by each Loan Authorization and Agreement were current and adequate. We reviewed the Federal Emergency and Management Agency's database of all current flood insurance policies, and contacted the insurance providers identified by borrowers during loan disbursement to determine whether the sampled loans had current flood and hazard insurance policies. To determine whether the flood and/or hazard insurance policies provided adequate coverage, we compared the current coverage amount obtained from flood and hazard insurance providers to the coverage amount recorded at loan disbursement. If the coverage had not decreased, then the current coverage amount was considered adequate. Because we relied on information available in the sample loan files, we did not contact borrowers sample borrowers to obtain additional information regarding insurance coverage.

To test the reliability of the universe data, we ensured that all disaster declaration numbers matched those of the disasters specified above, all final disbursement dates fell within the specified time range, all loan disbursement amounts were above $40,000, and that each loan carried flood insurance requirements.

The audit was conducted between March 2009 and June 2009 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States, and included such tests considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

APPENDIX II. SAMPLING METHODLOGY

We obtained a population universe of 23,068 loans associated with Hurricanes Ike and Gustav, the 2008 Midwest Floods, and Hurricanes Katrina, Rita, and Wilma whose: (1) final disbursement dates were on or between 01/01/06 and 12/31/08; (2) disbursed amounts exceeded $40,000; and (3) flood insurance stipulations covered collateral properties.

From this population universe, we randomly selected a statistical sample of 120 loans to estimate our population values. In statistically sampling, the estimate of attributes in the population universe has a measurable precision or sampling error. The precision is a measure of the expected difference between the value found in the sample and the value of the same characteristics that would have been found if a 100-percent review had been completed using the same techniques.

We calculated the population point estimates and the related lower and upper limits for the selected attributes using the Windows RAT-STATS statistical software program at a 90-percent confidence level. Projecting our sample results to the universe of 23,068 loans, we estimate that at least 5,341 loans lacked the required flood and/or hazard insurance, placing an aggregate outstanding balance of at least $510 million at undue risk.

OIG ESTIMATE OF LOANS LACKING ADEQUATE INSURANCE COVERAGE

	Occurrence in Sample of 120 Loans	Population Point Estimate	90 Percent Confidence	
			Lower Limit	Upper Limit
Number of loans	36	6,920	5,341	8,674
Outstanding Dollar Value	$3,764,171	$723,704,098	$510,396,287	$937,011,909

APPENDIX III. LOANS WITHOUT CURRENT OR ADEQUATE FLOOD AND/OR HAZARD INSURANCE

Sample	Loan Number	Exception	Outstanding Loan Balance / Amount At Risk		No Insurance Coverage			Inadequate Insurance Coverage
					Flood Only	Hazard Only	Both	Hazard Only
1	[FOIA ex. 2]	Yes	$27,725.00			X		
2	[FOIA ex. 2]	Yes	$238,126.00			X		
3	[FOIA ex. 2]	Yes	$61,411.00				X	
4	[FOIA ex. 2]	Yes	$113,761.00				X	
5	[FOIA ex. 2]	Yes	$44,972.00		X			
6	[FOIA ex. 2]	Yes	$113,716.00				X	
7	[FOIA ex. 2]	Yes	$34,785.00				X	
8	[FOIA ex. 2]	Yes	$226,645.00			X		
9	[FOIA ex. 2]	Yes	$72,558.00			X		
10	[FOIA ex. 2]	Yes	$226,098.00			X		
11	[FOIA ex. 2]	Yes	$161,686.00				X	
12	[FOIA ex. 2]	Yes	$58,627.00			X		
13	[FOIA ex. 2]	Yes	$135,035.00					X
14	[FOIA ex. 2]	Yes	$250,000.00				X	
15	[FOIA ex. 2]	Yes	$44,920.00				X	
16	[FOIA ex. 2]	Yes	$91,544.00			X		
17	[FOIA ex. 2]	Yes	$31,102.00		X			
18	[FOIA ex. 2]	Yes	$122,050.00			X		
19	[FOIA ex. 2]	Yes	$40,445.00				X	
20	[FOIA ex. 2]	Yes	$89,573.00		X			
21	[FOIA ex. 2]	Yes	$49,202.00				X	
22	[FOIA ex. 2]	Yes	$38,580.00			X		
23	[FOIA ex. 2]	Yes	$45,619.00		X			
24	[FOIA ex. 2]	Yes	$73,815.00			X		
25	[FOIA ex. 2]	Yes	$54,151.00			X		
26	[FOIA ex. 2]	Yes	$126,227.00			X		
27	[FOIA ex. 2]	Yes	$75,244.00			X		
28	[FOIA ex. 2]	Yes	$50,466.00			X		
29	[FOIA ex. 2]	Yes	$127,721.00			X		
30	[FOIA ex. 2]	Yes	$232,937.00				X	
31	[FOIA ex. 2]	Yes	$125,253.00				X	
32	[FOIA ex. 2]	Yes	$49,043.00		X			
33	[FOIA ex. 2]	Yes	$143,933.00			X		
34	[FOIA ex. 2]	Yes	$229,391.00			X		
35	[FOIA ex. 2]	Yes	$18,581.00			X		
36	[FOIA ex. 2]	Yes	$139,775.00			X		
TOTALS		**36**	**$3,764,717.00**		**5**	**19**	**11**	**1**

April 7, 1986

Office of Portfolio Management

Home Loan Center Polices Procedures

Harold W. Nossaman
Deputy Regional Administrator

We concur with Dave Ross' recommendation that loan files should remain in the Birmingham center if they were charged off there. We will be recommending that procedure for use throughout the country.

There are two other issues of interest to you. First, we recommend that all offices discontinue the practice of filing UCC continuations of lien where household goods are the collateral for a loan. Second, where manpower or volume is a problem, we do not require any followup on flood insurance or any extended pursuit of hazard insurance when a cancellation is received. This in no way waives the requirement of the borrower to maintain coverage. In addition, we suggest that insurance polices not be maintained in docket files. Instead, insurance companies can be advised that SBA should still be named as loss payee, but that we do not require physical possession of the policy.

We have yet to find a practical way to isolate statistics for the Region VII home loan portfolio within Region IV on a regular basis since the Region VII portfolio was merged in a way which does not allow for any regional preferences in the collection process. Some discussion has taken place on the matter, but so far our only option is to request special reports on an ad hoc basis. Clearly the merger has been a success. The combined portfolio at the outset had a delinquency rate of over 6% as against the present overall rate of 1.9%. The Region IV pre-merger rate was 2.4%.

Any other suggestions or comments regarding these issues will be appreciated.

[FOIA ex. 6]

Earl L. Chambers
Director
Office of Portfolio Management

cc: Al Symasek, Region IV
Dennis Bales, Region IV

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: October 13, 2009

To: Debra S. Ritt
Assistant Inspector General for Auditing

From: John A. Miller [FOIA ex. 6]
Director
Office of Financial Program Operations

Subject: OIG Draft Report – Monitoring of Insurance Coverage for Disaster Loan Recipients (Project No. 9301)

We have reviewed the Draft Report regarding the Monitoring of Insurance Coverage for the Disaster Loan Recipients. Our response indicates our concurrence with your recommendations. Our comments are noted below:

Recommendation #1: "Inform borrowers on the 36 loans with lapsed policies or insufficient coverage that they must provide evidence of adequate insurance coverage."

OFPO Response: *OFPO concurs with this recommendation and has taken the following actions to resolve the borrower's providing evidence of adequate flood and/or hazard insurance coverage.*

The Birmingham Disaster Servicing Center established contact or attempted to contact all 36 borrowers. Below is a summary of the results as of 9-29-09:

- *Verified that 17 of the 36 borrowers have the required flood and/or hazard insurance, 9 do not have the required flood and/or hazard insurance or lacked full coverage, and 10 could not be contacted and therefore no determination has been made.*
- *Of the 19 that either lacked flood and/or hazard insurance or were non-responsive, 8 were secured by a first lien on real estate. The Disaster Loan Servicing Centers will put their emphasis on these loans and attempt to obtain the required insurance.*

Loans Secured by 1st Lien on Real Estate with Missing Insurance	Required Flood Insurance Only	Required Hazard Insurance Only	Required both Flood and Hazard Insurance	Comments
Properties lacking insurance coverage	1	0	1	Collateral lacks insurance coverage
SBA has a 1st lien on the relocation property		1	1	SBA also has a 1st lien on disaster property and we will review further to determine if this is raw land (structure destroyed).
No response on follow-up	1	2	1	Borrowers did not respond or could not be located.
Total missing insurance coverage or non-responsive	2	3	3	Number of 1st lien positions without insurance

In cases where the SBA is in a first lien position on real estate, not in a Designated Flood Hazard Zone, and the owner does not have the required hazard insurance, the Disaster Loan Servicing Centers will notify the borrower that the SBA has the right to purchase (force place) hazard insurance coverage and that no further assistance may be granted until such proof of coverage is provided.

Recommendation #2: "Determine the actions needed to achieve compliance with statutory flood insurance monitoring requirements and the cost implications of achieving compliance."

OFPO Response: *OFPO appreciates that the OIG recognizes the difficulty of compliance on requiring and enforcing disaster borrowers to provide flood insurance on disaster loans. It is the position of OFPO that in a vast majority of disaster loans, the SBA has a junior lien position (best lien available) and that there is little if any equity in the disaster property. As flood insurance is only for replacement value of the damaged property there is not any immediate value to the SBA enforcing flood insurance on disaster loans where the SBA has a junior lien position.*

The law requiring the enforcement of insurance where the borrower has cancelled the insurance or allowed the insurance to lapse is already a requirement of the lender who is in the first lien position. In this regard, since the flood insurance held by the lender is for replacement value, there is no benefit to purchasing additional flood insurance.

OFPO takes the position that on all loans within a Designated Flood Hazard Zone, on which the SBA is in a first lien position, it is important that the mandatory requirements of forced flood insurance be met. On properties within a flood zone where flood insurance is mandatory Disaster Loan Servicing Centers will follow up to ensure that the borrowers are carrying the required flood insurance.

- *OFPO has requested ODA to query all disaster loans made since the establishment of the DCMS system in 2005, to identify all loans in which the SBA is in a first lien position on real estate securing the disaster loan.*
- *OFPO will develop and establish a trial project for achieving compliance as identified in Response #3 below.*

Recommendation #3: **"Develop and execute a plan for achieving compliance on existing and future loans. Alternatively, if achieving compliance is determined to be not cost effective, seek additional funding or a legislative change to the statutory flood insurance requirement."**

OFPO Response: *OFPO will establish a trial project and hire staff to begin the project by March 31, 2010. The project will monitor whether borrowers are maintaining flood insurance as mandated, and where coverage cannot be obtained through voluntary means, will confirm SBA's authorization to purchase "force placed" insurance and add it to the disaster debt, determine the methodologies available to do it, and if feasible, identify and implement the procedures (i.e. through a possible RFP) to carry it out. This project will last approximately 6 months through September 30, 2010. OFPO will evaluate the results between September 30, 2010 and December 31, 2010, and determine the appropriate actions, which may include fully or partially operationalizing this process in its disaster service centers by March 31, 2011.*

We anticipate that the trial project will include the following: the centers will monitor and ensure that all borrowers where SBA has a first lien position on real estate maintain flood insurance on the secured property. If the borrower refuses to purchase flood insurance, the centers will force-place the required flood insurance after due process notification.

It should be noted that the timeframe for this project will be subject to change dependent upon the timeframe for contracting the purchase of insurance and the complexity of the process for actually purchasing and force placing it.

Recommendation #4: **"Revise SOP 50-52 to clarify what action(s) servicing center personnel should take when borrowers refuse to obtain required hazard insurance."**

<u>OFPO Response:</u> *OFPO concurs with this recommendation and will amend the SOP 50-52 to reflect that the Disaster Loan Servicing Centers will follow-up through correspondence with borrowers, where the SBA has a first lien position on disaster property, and remind them of the requirement of maintaining hazard insurance, on those properties. The correspondence will notify the borrower that the SBA has the right to purchase (force place) insurance but that the cost of such insurance is likely greater than the cost the borrower would pay if the borrower purchased the required hazard insurance themselves. If the borrower does not provide proof of hazard insurance they will not be provided any further assistance unless the required hazard insurance is in place. It is anticipated that the rewrite of the 50 52 with this change will be submitted for clearance by 4-30-10.*