Alan Belkin
GCM

DECISION **THE COMPTROLLER GENERAL OF THE UNITED STATES** WASHINGTON, D.C. 20548

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FILE: B-183784 DATE: January 24, 1977

MATTER OF: Request for reconsideration of decision B-183784, January 23, 1976, involving National Housing Act mobile home loan insurance

DIGEST:

1. As stated in B-183784, January 23, 1976, claims under mobile home loan insurance pursuant to 12 U.S.C. § 1703 by lending institution presently delinquent in insurance premium payments may be allowed if default in loan occurred while premium payments were current. However, in accordance with applicable regulations, lender is required to continue to pay insurance premiums up to date claim is filed with HUD rather than date of default, and set-off of this amount against allowable claims is appropriate. B-183784, supra, clarified.

2. Although payment of insurance premiums in advance is required in order to maintain ongoing effective insurance coverage for mobile home loan insurance under 12 U.S.C. § 1703, payment of insurance premiums constitutes continuing obligation of lender that cannot be terminated prior to end of term of underlying loan. HUD has authority to set-off delinquent unpaid insurance premiums constituting existing debt presently due and payable to United States by lender against claims otherwise payable to lender, pending bankruptcy adjudication as to propriety of final setoff but may not withhold estimated future premiums. B-183784, January 23, 1976, is modified accordingly.

This decision is in response to two separate requests from officials of the Department of Housing and Urban Development (HUD) for our further views with respect to our decision B-183784, dated January 23, 1976, concerning the payment of insurance premiums, and the legal ramifications of delinquencies in insurance premium payments, with respect to mobile home loans issued under section 2, title 1, of the National Housing Act, as amended, 12 U.S.C. § 1703 (1970). Since the requests are closely related, essentially constituting requests for reconsideration and/or clarification of our decision of January 23, 1976, we will combine our responses into one decision. However, for reasons of clarity, each request will be dealt with separately herein.

In our January 23 decision we held that timely payment of required premiums is a prerequisite to insurance coverage for mobile home loans under 12 U.S.C. § 1703 and the implementing regulations. Accordingly, we concluded that HUD could not honor insurance claims with respect to which premium payments were not current either at the time of loan default or at a time when the lender had reason to believe that loan default was imminent. With respect to the collection of unpaid insurance premiums, we said that past due premium charges may be set-off against otherwise allowable claims if the lending institution agrees to such an action or, alternatively, that all remaining insurance coverage for the lender should be cancelled for non-payment of the required premiums. We indicated, however, that in neither event would the set-off of future premiums be appropriate. Finally, we recommended that the Secretary of HUD consider amending the current HUD regulations in order to avoid any recurrence of this situation by setting out the legal effect of a failure by an insured lending institution to pay the required insurance premiums in advance, as required by the statute.

In the initial request for reconsideration of this decision from Mr. John W. Kopecky, HUD Assistant General Counsel, the question was raised as to "* * * whether the Secretary is authorized to provide that an insured may 'terminate' insurance coverage simply by failing to remit insurance premiums when due * * *." This issue will be fully discussed in the latter portion of this decision.

Subsequently, we received a letter from Mr. B. C. Tyner, Authorized Certifying Officer, HUD, requesting our advice as to the propriety of certifying a voucher presented to him in the amount of $2,934.02 covering a claim by the First Colonial Life Insurance Company, the same lender that was involved in the original decision. The voucher covers a claim on a loan made by First Colonial on June 1, 1972, for the purchase of a mobile home. The loan was made and submitted to HUD for insurance in accordance with 12 U.S.C. § 1703 and regulations issued pursuant thereto, 24 C.F.R. §§ 201.501 _et seq_. (1976).

As explained in the certifying officer's letter to us, the premium on the loan was current at the time of default by the borrower on September 1, 1973, but was delinquent and unpaid when the claim was actually filed by the insured lender on October 25, 1974. According to the submission, the instant question as to the propriety of honoring this claim has arisen as a result of what we said in the following paragraph from our decision of June 23, 1976:

"Turning to the specific claim accompanying the instant submission, as noted previously, default occurred (June 1, 1973) well before the lender became delinquent in its premium payments (September 1, 1974), even though the claim was actually filed (September 20, 1974) after the first nonpayment of premiums. Accordingly, this particular loan was covered by insurance at the time of default, and may be honored if otherwise proper. The certifying officer's submission to us does not describe the precise timing of the other pending claims by First Colonial, which should, of course, be disposed of in accordance with the conclusions expressed herein."

The certifying officer who submitted this question to us apparently believed that this language necessarily conflicted with the applicable regulations set forth in 24 C.F.R. § 201.640, which have been consistently interpreted by HUD as requiring that an insured lender continue to pay insurance premiums up to the date of claim without regard to whether the loan in question was current or in default. In our January 23 decision we were primarily concerned with the question of whether insurance coverage could remain in effect where the lending institution failed to pay its insurance premium "in advance" as required by the statute. We determined that payment of the required premiums "in advance," albeit on an annual basis (as prescribed by the regulations), was a prerequisite to continued insurance coverage. Accordingly, we concluded that claims could only be allowed for those loans that went into default while premium payments were still current, but would have to be disallowed when the default occurred or became imminent at some time after the premium delinquency arose. Thus, the language from that decision which was specifically quoted in the certifying officer's submission actually stands for the proposition that the particular claim involved there could be honored even though it was actually filed after the first nonpayment of premiums since the underlying loan was covered at the time the default that led to the claim occurred.

The certifying officer's primary concern is that the lender should be required to continue to pay insurance premiums up to the date the claim is filed rather than the date of default. We do not disagree with this conclusion. The applicable regulatory provisions, set forth at 24 C.F.R. § 201.640, provide as follows:

> "Refund or Abatement of Insurance Charge
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> "An insured shall be entitled to a refund or abatement of insurance charges only in the following instances:
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> (a) Where the obligation has been refinanced, the unearned portion of the charge on the original obligation shall be credited to the charge on the refinanced loan.
>
> (b) Where the obligation is prepaid in full or an insurance claim is filed, charges falling due after such prepayment or claim shall be abated.
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> (c) Where a loan (or a portion thereof) is found to be ineligible for insurance, charges paid on the ineligible portion shall be refunded. Such refund shall be made, however, only if a claim is denied by the Commissioner or the ineligibility is reported by the insured promptly upon discovery. In no event shall a charge be refunded on the basis of loan ineligibility where the application for refund is made after the loan has been paid in full."

In our prior decision, we noted that since this provision provides that insurance premiums falling due after the filing of an insurance claim are abated, "there would be no past due premiums to set-off on loans which went into default while premium payments were current and for which insurance claims are now pending with HUD." We did not intend to suggest that an insured lending institution was relieved of its obligation to continue to pay insurance premiums in the interval between the date of default and the date the claim was filed. We believe that the meaning of 24 C.F.R. § 201.640 is clear, i.e., that only the filing of an insurance claim with HUD, rather than the mere default by the borrower, abates premium charges. However, where premium payments are current at the time of default, we do not believe that nonpayment of premiums after default but before filing of a claim defeats the validity of the claim itself. See 43 Am. Jur. 2d, Insurance, § 621, at 629-630, which states the general rule that:

> "* * * If the premium or assessment is not due until after a loss has occurred, failure to make payment thereof does not work a forfeiture of the policy."

In view of the foregoing, the proper procedure to follow for a claim such as the one here presented by the certifying officer is to honor the claim but set off against it unpaid premiums attributable to that claim arising between default and the date of filing of the claim, pursuant to the Government's customary right of set-off. See e.g., 41 Comp. Gen. 178 (1961); 28 id. 543 (1949), and cases cited. Accordingly, the voucher presented may be paid, if otherwise correct, upon set-off of the appropriate premium amounts. Our decision of January 23, 1976, supra, is hereby clarified to the extent that it might be read to suggest a contrary result.

Finally, we note that although it appears on the basis of the original submission from HUD that First Colonial was and apparently still is involved in a bankruptcy proceeding (we have no precise information as to First Colonial's current status), we do not believe that this significantly affects the Government's right of set-off. In this regard 11 U.S.C. § 108(a)(1970) specifically provides that "in all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid." Although this section has been held not to be self-executing, we believe that HUD would certainly have the right before paying any claim to withhold an amount equivalent to all unpaid premiums due from a lender between the date of default and the date the claim is filed, pending an adjudication by the bankruptcy court as to the propriety of a final set-off of this amount.

Turning to the request from Mr. Kopecky, a different issue, although one that is related to the certifying officer's request, is involved. The certifying officer was primarily concerned with the insured's legal obligation to continue to pay insurance premiums on defaulted loans until such time as claims thereon are actually filed. Mr. Kopecky's submission, on the other hand, suggests that lending institutions should not be permitted to unilaterally terminate their insurance coverage and their reciprocal obligation to continue to pay insurance premiums on loans that have not gone into default merely by failing to pay such premiums as they become due even when the real possibility exists that no additional insurance coverage will be forthcoming and any new claims could not, therefore, be honored. As stated in our decision of January 23, 1976, that possibility exists because of the statutory limitation in 12 U.S.C. § 1703(a) that insurance granted to a lending institution thereunder not exceed 10 percent of its eligible loans. To implement this provision, HUD regulations provide for the establishment of a general insurance reserve for each lender which is designed to maintain the amount of a lender's reserve at 10 percent of its outstanding loan balance, less claims approved for payment. See 24 C.F.R. §§ 201.12 and 201.675 (1976). We have informally been advised that the total amount of all claims from First Colonial presently pending with HUD may exceed the 10 percent insurance reserve, in which case no additional insurance protection from HUD would be available.

As explained above, our decision of January 23, 1976, was primarily concerned with the issue of whether an insured loan would retain its insured status even if the lending institution did not continue to pay its insurance premiums "in advance" as required by 12 U.S.C. § 1703(f). We held that the purpose of the statutory requirement for advance payment of insurance premiums was to prevent the insured from being protected by insurance for which he has not paid. We therefore concluded that any loans that went into default after the premium delinquency arose were not covered by insurance. HUD does not disagree with this conclusion. Thus, in its letter to us of May 5, 1976, responding to a request for additional clarification of its views in this regard HUD took the following position:

> "The Title I Regulations make no provision for voluntary termination of insurance coverage or for a termination charge. In the event of a failure of an insured lender to timely remit insurance charges when due it would, however, be our view that insurance coverage would lapse, and the Secretary would not be obligated to honor a claim where the insurance charge for the loan had not been paid. Under such circumstances, of course, it would be difficult to continue to press the insured lender for payment of the unpaid insurance charges.* * *"

However, our January 23 decision also held, at least implicitly, that any lender had the general option of deciding whether or not to continue its insurance coverage and that therefore it would not be proper to set-off past due premiums attributable to loans not yet in default without First Colonial's consent since continued insurance coverage might not be desired. It is this portion of our decision that has been questioned by HUD. Upon consideration of this specific issue, we agree that insured lending institutions are legally obligated to continue to pay insurance premiums over the full term of insured loans, and cannot unilaterally terminate their insurance coverage simply by failing to remit insurance premiums when due. Accordingly, unpaid insurance premiums can be set off against allowable claims without the consent of the lending institution involved. The basis for our conclusion in this regard is set forth hereafter.

The relevant statutory provision with respect to the payment of insurance premiums for mobile home loan insurance is contained in 12 U.S.C. § 1703(f) as follows:

> "The Secretary shall fix a premium charge for the insurance hereafter granted under this section, but in the case of any obligation representing any loan, advance of credit, or purchase, such premium charge shall not exceed an amount equivalent to 1 per centum per annum of the <u>net proceeds</u> of such loan, advance, or purchase, <u>for the term of such obligation</u>, and such premium charge shall be payable in advance by the financial institution and shall be paid at such time and in such manner as may be prescribed by the Secretary."
> (Emphasis added.)

HUD believes that this provision requires lending institutions to continue to pay insurance premium charges over the full term of insured obligations, and does not allow lenders to terminate their insurance coverage and their reciprocal obligation to continue to pay such premiums until the obligation has matured, been prepaid, or until a claim thereon has been filed. See 24 C.F.R. § 201.640 (1976), supra. The basis for abating premium charges falling due after a loan has been prepaid or a claim has been filed, as explained in HUD's clarifying letter to us of May 5, 1976, is that in both cases the term of the obligation would have ended either because of the prepayment or by reason of the acceleration of the note upon its default. Moreover, HUD's view with respect to the Title I insurance program, as explained in its letter to us of May 5, 1976 "is that the entire insurance premium is due when a loan is accepted for insurance but that the premium may be payable in installments commensurate with the terms of the obligation." See 24 C.F.R. § 20[illegible]30(a) and (b) (1976).

Although we believe that, standing alone, 12 U.S.C. § 1703(f) is somewhat ambiguous and is susceptible to other interpretations, we also believe that any doubt as to the intended meaning of this provision is removed upon consideration of another provision of the National Housing Act, 12 U.S.C. § 1715(t)(1970), which provides as follows:

> "Voluntary termination of insurance.
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> Notwithstanding any other provision of the Act and with respect to any loan or mortgage heretofor or hereafter insured under this Act, except under Section 1703 of this title, the Secretary is authorized to terminate any insurance contract upon request by the borrower or mortgagor and upon payment of such termination charge as the Secretary determines to be equitable, taking into consideration the necessity of protecting the various insurance funds.
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> Upon such termination, borrowers and mortgagors and financial institutions and mortgagees shall be entitled to the rights, if any, to which they would be entitled under this Act if the insurance contract were terminated by payment in full of the insured loan or mortgage."
> (Emphasis added.)

HUD relies quite heavily upon this provision in support of its position that lenders under section 1703 cannot unilaterally terminate their insurance merely by discontinuing premium payments. We agree with HUD's position. The clear implication of this specific provision for termination is that, once a loan is submitted and accepted for insurance under section 1703, neither the Secretary of HUD nor the insured lender can terminate such insurance either unilaterally or by mutual agreement until the term of the obligation has expired. Certainly, it would be anomalous to conclude that this provision only refers to the voluntary, mutually agreed upon termination of insurance, but does not restrict a lender's right to unilaterally terminate its insurance coverage by discontinuing further premium payments as they become due.

Although our review of the legislative history of 12 U.S.C. § 1703 does not reveal any information that would be helpful in resolving the issue under consideration here, our examination of the legislative history of 12 U.S.C. § 1715(t), when it was first enacted as section 612(1) of Pub. L. No. 87-70, approved June 30, 1961, definitely supports the view that insurance under section 1703 cannot be terminated prior to the expiration of the term of the obligations involved. The report of the Senate Committee on Banking and Currency on this legislation explains the purpose of this provision as follows:

> "Voluntary termination of FHA insurance on multifamily housing mortgages and loans.
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> Section 509(k) would permit voluntary termination of FHA insurance of a loan or mortgage covering multifamily housing project. The insurance could be terminated if the borrower and the lender both make the request. The Commissioner has authority to impose termination charges in such cases. The new programs which would be authorized by the bill would be included under the provision. Under present law FHA has this authority only with respect to one- to four-family home mortgages. FHA insurance cannot now be terminated on a loan covering a multifamily structure unless the mortgage is prepaid."
> S. Rep. No. 281, 87th Cong., 1st Sess., 40 (1961). (Emphasis added.)

As this explanation indicates, insurance issued under the National Housing Act, as amended, cannot be voluntarily terminated unless a provision such as that contained in 12 U.S.C. § 1715(t) is applicable thereto. It follows that since this provision expressly provides that it does not apply to insurance issued under 12 U.S.C. § 1703, such insurance cannot be terminated voluntarily or otherwise, for purposes of premium payments, prior to the end of the term of the obligations involved.

Although this result may seem harsh, especially in a situation where the lending institution may be required to continue to pay premiums even though the 10 percent insurance reserve becomes exhausted and no additional insurance protection will be provided by HUD, we believe that there are additional reasons for reaching this conclusion. For one thing, it appears that the Title I insurance program is self-supporting and that premium income has been sufficient to cover both losses and operating expenses under the program. See S. Rep. No. 281, supra, 40. It is reasonable to assume that the self-sufficiency of this program is predicated on the statutory arrangement that lending institutions must pay a premium which is based on all of the loans submitted for insurance, even though the insured can only collect on a maximum of 10 percent of that total. Of course, this statutory arrangement can only be effective if lending institutions are not allowed, once a loan is submitted and accepted for issuance, to terminate the insurance thereon. The statutory arrangement, as well as the program's self-sufficiency, might be defeated if a lending institution was permitted to stop paying premiums after the 10 percent figure is reached and the insurance reserve is exhausted. In this regard we should point out that 12 C.F.R. § 201.640, supra, which sets forth the only circumstances in which refunds or abatements of premium charges are permissible does not include unilateral, or, for that matter, the mutual, termination of insurance coverage or the exhaustion of the insurance reserve.

Also, in its letter of May 5, 1976, HUD said the following in this regard:

> "* * * the fact that the statutory liability of the Secretary to honor claims may have ended by reason of exhaustion of the insurance reserve would not necessarily dictate that the insured lender's obligation to continue to pay insurance installments has also ended. Instances have arisen involving similar situations where a bank has been declared insolvent and the insurance reserve exhausted. In such cases the insuring agency (FDIC, FSLIC, etc.) has arranged with the succeeding financial institution to pay the insurance installments to the Secretary on loans previously acknowledged for insurance by the Secretary even though there was no possibility of future claims being honored by the Secretary."

We have found judicial precedent for this position. Section 407(a) of the National Housing Act, 12 U.S.C. § 1730, at one time required any savings and loan association that wished to terminate its deposit insurance with the Federal Savings and Loan Insurance Corporation to continue to pay the premium charges for such insurance "for a period of three years after the date of such termination * * *." Section 407(a) also provided that once an insured institution so terminates its insured status, its accounts were no longer covered by insurance. In the case of Federal Savings and Loan Insurance Corporation v. Edison Savings and Loan Association, 83 F. Supp. 1007 (S.D. N.Y.) (1949) this provision was attacked on the following grounds:

> "* * * the failure to furnish insurance coverage for premiums allegedly due makes the contract void and unenforcible for want of consideration; since the plaintiff assumes no risk it is not lawfully entitled to premiums; since the plaintiff, after demand, refused to give insurance coverage the defendant is now relieved of any obligation to pay premiums; since the defendant ceased to be an insured institution it ceased to have any insured accounts upon which a premium could be computed under Section 404(a) of the Act, 12 U.S.C.A. § 1727(a); to require defendant to pay premiums without affording it coverage would be to deprive the defendant, its members and shareholders of property without just compensation and without due process in violation of Article V of the Amendments to the Constitution of the United States."

After considering and rejecting each of these arguments in turn, the court concluded that the statutory requirement, however burdensome, was clear and unambiguous and did in fact require the lending institutions to continue to pay the required insurance premiums, although no additional insurance coverage was available. Also, in this regard see Federal Savings and Loan Insurance Corporation v. Grand Forks Building and Loan Association, 85 F. Supp. 248 (D. N.D. 1949).

We believe that the same principle enunciated in the above-cited case is applicable here. Reading 12 U.S.C. §§ 1703(f) and 1715(t) together, as well as the legislative history of the latter provision, the congressional intent becomes clear that once a loan is accepted for insurance under 12 U.S.C. § 1703, the lender must continue to pay premiums until the term of the loan has ended even if the loan is no longer covered by insurance.

In accordance with the foregoing, and notwithstanding anything to the contrary in our decision of January 23, 1976, we now believe that payment of the insurance premiums on loans insured under 12 U.S.C. § 1703 constitutes a continuing obligation of a participating lending institution that cannot be terminated prior to the end of the term of the underlying loans and must, therefore, be paid by the lender as such premiums become due regardless of possible exhaustion of the insurance reserve. However, we continue to believe for the reasons stated in our decision of January 23, 1976, that payment of such premiums in advance is required in order to maintain active, ongoing insurance coverage. Therefore, claims cannot be honored if the default in the insured loan occurred after the premium delinquency arose.

Having reached this conclusion, we are faced with the question of how best to proceed in the instant case to effect a collection of the unpaid premiums. As stated in 41 Comp. Gen. 178 and 28 id. 543, supra, it has consistently been held that the Government has the same right of set off as do other creditors. Accordingly, we believe that, HUD has the authority to set off delinquent unpaid insurance premiums constituting an existing debt presently due and payable to the United States by First Colonial against allowed insurance claims payable by HUD to First Colonial. However, this set off would not include amounts attributable to loans which went into default while premium payments therefor were not current since such loans have ceased to be eligible for insurance. Cf., 24 C.F.R. § 201.640(c), supra.

As stated above, we do not believe that the fact of First Colonial's involvement in a bankruptcy proceeding significantly affects the Government's right of set-off in this regard, since 11 U.S.C. § 108 specifically provides for the set-off of mutual debts by any creditor in such a situation. Although that section is not self-executing, we believe that prior to paying any claims HUD would be justified in withholding an amount equivalent to the total of all delinquent premiums that are due and owing as of the date the claims are to be paid pending an adjudication by the appropriate court or the trustee in bankruptcy as to the propriety of a final set-off.

The situation with respect to the payment of premiums that will become due in the future is different however. In light of our conclusion that payment of the insurance premium pursuant to 24 C.F.R. § 201.630(b) constitutes a continuing obligation of the lender that cannot be terminated prior to the end of the loan term, we believe that the unpaid insurance premium which will become due in the future can be likened to an unmatured debt which is owing but has not yet become due. The general rule with respect to the set-off of unmatured debts is stated in pertinent part as follows in 20 Am. Jur. 2d, Counterclaims, Recoupment, and Setoff § 57:

> "Generally, a claim or demand of a defendant against the plaintiff must be due and owing at the commencement of the action in order to be available as a setoff or counterclaim. The basis of the general rule is the principle that all issues in an action are to be determined as of its date of commencement. To allow a debt not due to be set off against one already due would be to change the contract and advance the time of payment. In other words, the general statutes of setoff and counterclaim apply to mutual debts only and do not comprehend mutual credits. Mutual debts, in the purview of a statute of setoff, are not merely those which are owing, but those which are due and payable, on each of which the cause of action has accrued and exists at the same time, while they are mutual credits if either remains to be paid at a future day."

It is generally held that set-off is only appropriate when the debt involved is liquidated and certain in amount. See 20 Am. Jur. 2d, Counterclaims, Recoupment, and Setoff § 61. However, it is possible that some loans may go into default or be paid in full before their term (as fixed in the loan agreement) is ended, thus reducing--under the abatement provisions of 12 C.F.R. § 201.640--the amount of insurance premiums that would become due in the future. Thus there is presently no debt for future premiums which is certain in amount. Accordingly, although it is our view that the lender's obligation to pay insurance premiums is a continuing one, we do not believe that it would be proper for HUD to set-off estimated premiums that might become due in the future against claims by First Colonial that are currently payable.

As stated above, to the extent that anything in our decision B-183784, January 23, 1976, is inconsistent with what we have said herein, the previous decision is modified accordingly.

R. F. Keller

Deputy Comptroller General
of the United States