DECISION

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

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FILE: B-183784

DATE: JAN 23 1976

MATTER OF:

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National Housing Act mobile home loan insurance delinquent insurance premium payments

DIGEST:

1. Timely payment by insured lender of premiums for mobile home loan insurance under section 2, title I, of National Housing Act, as amended, 12 U.S.C.A. § 1703--which requires payment of premiums "in advance"--is a prerequisite to continued insurance coverage. There is no basis for implication, underlying HUD proposal to set off against insurance claims past due and future premiums of delinquent lending institution, that insurance coverage is unaffected by non-payment of premiums.

2. Claims under mobile home loan insurance pursuant to 12 U.S.C.A. § 1703 by lending institution presently delinquent in insurance premium payments may be allowed if default on loan occurred while premium payments were current, but cannot be allowed if default occurred or was imminent after premium payments became delinquent. Past due premium charges may be set off against allowable claims, if lender agrees to such setoff. Alternatively, remaining insurance coverage may be cancelled. In no event is set-off of future premium charges appropriate.

3. GAO recommends, pursuant to 31 U.S.C.A. § 1176, that HUD regulations be amended in terms of foregoing issues and conclusions.

Mr. B. C. Tyner, Authorized Certifying Officer, Department of Housing and Urban Development (HUD), has requested our decision concerning the propriety of certifying a voucher presented to him in the amount of $7,533.31 covering a claim by the First Colonial Life Insurance Company and then setting off past due and future insurance premiums that have not been paid by First Colonial against the funds otherwise payable under the voucher. This claim, which is one of 30 similar claims by First Colonial that are presently pending at HUD, represents a request for reimbursement of a loss sustained on a loan made by the insured lending institution for the purchase of a mobile home. The loan was made and submitted to HUD for insurance pursuant to section 2, title I, of the National Housing Act, as amended, 12 U.S.C.A. § 1703, and regulations issued pursuant thereto, 24 C.F.R. §§ 201.501 et seq. (1975).

The pertinent facts and circumstances concerning this matter as disclosed in the certifying officer's letter are set forth below.

The borrowers obtained $10,000 from the First Colonial Life Insurance Company on February 6, 1973, to purchase the mobile home. According to the record presented to us, the loan went into default on June 1, 1973, after payments of only $318.59, and demand for the full unpaid balance was made on July 30, 1973. Subsequently the home was repossessed and sold at a substantial loss, leaving a reimbursable amount of $7,533.31 which the First Colonial submitted to HUD for payment on September 20, 1974.

In August 1974, First Colonial filed a plan of reorganization under Chapter X of the Bankruptcy Act, as a result of which HUD initiated a review of the entire loan portfolio of the lending institution. Pursuant to this review, and after certain deductions were made for ineligible loans, it was determined that the total insurance reserve for First Colonial was $398,736.04. HUD's review also revealed that loans by First Colonial in excess of $1,000,000 were seriously delinquent although not yet in default. Since First Colonial already had 30 claims pending at HUD (as of April 22, 1975), totaling approximately $227,580.00, the certifying officer expresses concern that exhaustion of the lender's insurance reserve is a distinct possibility, in which case the lender may lack the funds or the incentive to make future insurance premium payments as required. The lender has already been advised that its reserve has been frozen and that new loans will not be accepted for insurance. The certifying officer also points out that First Colonial has been delinquent in making insurance premium payments since September 1, 1974, with a total amount of $12,203.25 past due as of March 1, 1975.

In view of the foregoing, our opinion is requested as to the propriety of HUD's setting off past and future unpaid insurance premiums against the funds otherwise payable under the voucher submitted to us (and presumably First Colonial's other claims as well). In the event we conclude that set-off of future unpaid premiums is permissible, we are also requested to determine whether a computation of present value of future premiums should be made and, if so, at what rate of discount.

For purposes of the questions submitted to us 12 U.S.C.A. § 1703 provides in pertinent part as follows:

> "(a) The Secretary is authorized and empowered upon such terms and conditions as he may prescribe, to insure banks, trust companies, personal finance companies, mortgage companies, building and loan associations, installment lending companies and

other such financial institutions, which the Secretary finds to be qualified by experience or facilities and approves as eligible for credit insurance, against losses which they may sustain as a result of loans and advances of credit, and purchases of obligations representing loans and advances of credit, made by them on and after July 1, 1939, and prior to June 30, 1977, for the purpose of * * * (ii) financing the purchase of a mobile home to be used by the owner as his principal residence or financing the purchase of a lot on which to place such home and paying expenses reasonably necessary for the appropriate preparation of such lot, including the installation of utility connections, sanitary facilities, and paving, and the construction of a suitable pad, or financing only the acquisition of such a lot either with or without such preparation by an owner of a mobile home. In no case shall the insurance granted by the Secretary under this section to any such financial institution on loans, advances of credit, and purchases made by such financial institution for such purposes on and after July 1, 1939, exceed 10 per centum of the total amount of such loans, advances of credit, and purchases: Provided, That with respect to any loan, advance of credit, or purchase made after the effective date of the Housing Act of 1954, the amount of any claim for loss on any such individual loan, advance of credit, or purchase paid by the Secretary under the provisions of this section to a lending institution shall not exceed 90 per centum of such loss.

* * * * *

"(f) 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 net proceeds of such loan, advance of credit, or purchase, for the term of such obligation, 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."

To implement the requirement of section 1703(a) that insurance granted to a lending institution not exceed 10 percent of its eligible loans, HUD regulations provide a general insurance reserve for each lender, 24 C.F.R. § 201.12, which is made applicable to mobile home loan

insurance. Id., § 201.675. Apparently this regulatory provision is designed to maintain the amount of a lender's reserve at 10 percent of its outstanding insured loan balance, less claims approved for payment. An insured lender can only be reimbursed by HUD for 90 percent of a claimed loss on an eligible loan up to the amount of its insurance reserve. Id., § 201.680.

With respect to insurance premiums, the regulations impose a charge equal to .54 of 1 percent per annum of the net proceeds of any loan reported and acknowledged for insurance. Id., § 201.625. The times for payment of insurance premiums are specified in section 201.630 of the regulations as follows:

> "(a) Single payment. On loans having a maturity of 25 months or less, the insurance charge for the entire term of the loan shall be paid within 25 days after the date the Commissioner acknowledges to the insured institution the receipt of the report of the loan.
>
> "(b) Installment payments. On loans having a maturity in excess of 25 months the insurance charge shall be payable in installments. The first installment shall be equal to the charge for 1 year and be paid within 25 days of the Commissioner's acknowledgement of the loan report. The second and succeeding installments each equal to the charge for 1 year, shall be paid within 25 days after billing by the Commissioner on an annual basis."

The questions submitted to us by the certifying officer, particularly as to set-off of "future premiums," implicitly but necessarily assume that insurance coverage continues even if the required premium payments are not made. However, we cannot accept this assumption.

Under 12 U.S.C.A. § 1703(f), supra, insurance premium charges "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." This requirement for premium charges derives originally from section 2 of the act approved June 3, 1939, ch. 175, 53 Stat. 804, 805. Prior to that amendment no premiums were required. The charges imposed in 1939 were designed to defray the Federal Housing Administration's administrative and operating expenses and to assist in reducing losses to the Government. See, e.g., H.R. Rep. No. 313, 76th Cong., 1st sess., 1 (1939); 84 Cong. Rec. 4119 (1939) (remarks of Representative Wolcott); id., 4829 (remarks of Senator Brown).

The legislative history of the 1939 amendment does not expressly address the requirement for payment "in advance." However, it has been held that the purpose of statutory requirements for advance payment of insurance premiums is to prevent the insured from being protected by insurance for which he has not paid. 44 C.J.S., Insurance, § 345, pp. 1315-16. Similarly, when the insurance contract provides that premiums are payable in installments, each installment must be paid when it becomes due in order to keep the policy in force, unless payment is waived or excused by the insurer. Id., 1317-18. These interpretations are consistent with the general rule that the time of payment of premiums is material and of the essence of an insurance contract, id. at 1315, and seem fully applicable to the loan insurance here involved under 12 U.S.C.A. § 1703.

Section 201.630 of the HUD regulations, supra, requires full payment of the insurance premium for loans having a maturity of 25 months or less within 25 days following acknowledgment of the loan report. For loans having a longer maturity period, premiums are payable in annual installments. The first payment is due within 25 days of acknowledgment, and subsequent installments shall be paid within 25 days after billing therefor. The premium charge schedule contained in this regulation presumably reflects the Secretary's discretion to prescribe the precise time and manner of payment. It is not, in our view, inconsistent with the statutory requirement for payment "in advance" in the sense that the basic effect of such requirement is to make premium payments a prerequisite for initial and continued insurance coverage. We note in this regard that the first Federal Housing Administration regulations issued after enactment of the 1939 amendment requiring insurance premiums expressly provided (with respect to programs then in effect) that installment premium charges "may be paid annually in advance during the term of the loan * * *." § 501.17(b), 4 Fed. Reg. 3789, 3794 (September 1, 1939) (Emphasis supplied). These initial regulations also expressly conditioned insurance coverage upon payment of premium charges:

> "Subject to the other provisions of these Regulations, the insurance granted under Title I of the National Housing Act, as amended, shall be effective with respect to any loan from the date of the report thereof to the Administrator provided that the insurance charge with respect to such loan has been paid as required by this Regulation." § 501.17(g), id. at 3795 (Emphasis supplied).

While the current regulations applicable to insurance for mobile home loans do not expressly include the above-quoted provisions, we see no basis to infer that their absence reflects a substantive departure from the original administrative construction of what is now 12 U.S.C.A. § 1703(f).

Consistent with the foregoing observations, our decision of July 16, 1971, B-172965, to a HUD certifying officer declined to approve payment of an insurance claim under 12 U.S.C.A. § 1703 in part on the basis that the insurance premium had not been remitted to HUD. Our 1971 decision construed section 1703(f) to require the premium payment in advance in order for a loan to be eligible for insurance, at least when nonpayment of the premium is solely the fault of the financial institution. It is particularly notable that in the 1971 decision nonpayment of the premium resulted from an administrative oversight by the claimant bank, rather than a presumably knowing failure to pay such as in the present case.

For the reasons stated above, we believe that timely payment of required premiums is a prerequisite to insurance coverage for mobile home loans under 12 U.S.C.A. § 1703 and implementing regulations. Consequently, it is further our opinion that HUD may not honor insurance claims with respect to which premium payments are not current either at the time of loan default or at a time when the lender has reason to believe that loan default is imminent. Any other approach not only seems contrary to the authorities discussed herein but would defy all reason and common sense. However, we have no objection to the allowance of claims on loans for which premiums were current at the time of default since insurance coverage was then in effect. Cf., B-181432, March 13, 1975, wherein we followed an analogous approach in considering the timing of fee payments under a Small Business Administration loan guaranty program.

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.

With respect to the certifying officer's first question concerning set-off of past due premiums, we believe that either of two alternative approaches is possible. As stated previously, it is our view that the lending institution's insurance coverage has lapsed for loans on which premium payments are not current, since the statute requires that the premium payments be made in advance. Thus one alternative would be to formally advise First Colonial that insurance on such loans is cancelled. In this event, there would be no basis for set-off of past due premiums. We note in this regard that under 24 C.F.R. § 201.640(b), insurance premiums falling due after filing of an insurance claim are abated. Thus 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.

The other possible alternative would be to deduct from the instant claim, and any additional claims by First Colonial which qualify for payment under the conclusions herein, past due premiums attributable to loans not yet in default. To the extent that allowable pending claims by First Colonial are sufficient to make current its premium payments, the basic result of set-off would be to reinstate lapsed insurance coverage for such loans. However, such an approach could be pursued only with First Colonial's agreement, since the lender may not desire to continue insurance coverage. If this alternative is adopted, with First Colonial's consent, two additional caveats must be emphasized. First, the set-off may not include amounts attributable to loans which went into default while premium payments therefor were not current since in no event are these loans eligible for insurance. Second, if a further delinquency in premium payments occurs after initial reinstatement by set-off, we believe that any remaining insurance should immediately be cancelled. In this regard, we consider the alternative of initially reinstating First Colonial's insurance to be permissible only due to the unique circumstances and status of this particular case. In our view, cancellation is generally the appropriate remedy in case of nonpayment of premiums by an insured lending institution.

With respect to the certifying officer's second question, it is our opinion for the reasons already stated that no basis exists for set-off of "future" unpaid premiums under any of the considerations and alternatives discussed above.

Finally, in order to avoid the situation which has developed in this case, and as a matter of fairness to all concerned, we recommend to the Secretary of Housing and Urban Development that appropriate amendments to the current HUD regulations be considered in terms of the issues and conclusions discussed herein.

This recommendation is made pursuant to section 236 of the Legislative Reorganization Act of 1970, 31 U.S.C.A. § 1176. Accordingly, copies of the decision are being sent to the Secretary and to the appropriate congressional committees.

R.F.KELLER

Deputy Comptroller General
of the United States