CFA's and CEJ's Continuing Objection to the Approval of

Praetorian Insurance Company Lender-Placed Insurance Rate Filing No 12-20015

January 11, 2013

The Consumer Federation of America and the Center for Economic Justice continue to object to the approval of the Praetorian lender-placed insurance (LPI) rate filing number 12-20015, submitted in December 2012.

The proposed rates continue to be significantly excessive and unfairly discriminatory and should be disapproved.

In addition, we again call on the Office of Insurance Regulation (OIR) to direct QBE FIRST and QBE Specialty Insurance Company to cease issuing LPI through surplus lines. It is simply not possible for QBE FIRST – the administrator of the QBE LPI program – to satisfy the statutory due diligence requirements for placing surplus lines business when an affiliate of QBE of both QBE FIRST and QBE Specialty – namely, Balboa Insurance Company – is writing LPI in the admitted market.

The changes from the May 2012 rate filing are modest:

1. Reduction of commission from 15% to 11%
2. Reduction of Non-FHCF Reinsurance Cost from 22.3% to 18.5%
3. Increased Projected Hurricane Loss and LAE ratio from 15.9% to 16.4%
4. Decreased Non-Hurricane Loss and LAE ratio from 15.7% to 14.8%

The proposed rates remain significantly excessive because

1. The proposed rates are significantly higher than Praetorian's own indicated rates
2. The indicated rates are significantly excessive because of
    a. Excessive commissions and general expenses
    b. The use of a negative premium trend
    c. Excessive loss trend

Praetorian has claimed trade secret on all exhibits supporting the proposed reinsurance costs. Consequently, a member of the public cannot review the proposed reinsurance load for reasonableness. However, we note that that the modeled hurricane losses have increased in the latest rate filing and the reinsurance costs are 18.5% of premium paid to a an affiliated reinsure (Equator Reinsurance Limited). Give that LPI does not provide coverage for contents or additional living expense and given that the reinsurance is an affiliated transaction, the proposed reinsurance costs and support require close examination. We respectfully request copies of the Exhibits 15A through 22 of the rate filing, which were not available for download from the OIR rate filing tool.

The rates remain unfairly discriminatory because of the presence of the "Rate Modification Plan" which would allow Praetorian to arbitrarily change rates for different mortgage servicers, and by extension, for different groups of consumers. The scheduled rating factors should be disapproved and those factors which can be utilized on an objective basis should be introduced as rating factors. If Praetorian has support to demonstrate actual and expected losses associated with any particular scheduled rating factor, that factor should be introduced as an objectively-applied rating factor. If Praetorian does not have such support, the factor should not be permitted.

CFA's and CEJ's comments on the prior Praetorian rate filing presented at the July 3, 2012 public hearing contain important information on the roles of mortgage servicers, LPI insurers and vendors of LPI-related services, like insurance tracking. We refer the OIR to those comments for further support of our objection.

Rate Filing Representations

We doubt that Praetorian itself believes the representations they make in the rate filing regarding expected claims, expenses and profits. We base this conclusion on the unreasonableness of the various rate elements presented and also on the disparity between the representations made by the other major LPI insurer Assurant in its rate filing and representations by Assurant to investment analysts. In slide 34 of Assurant's March 2012 presentation to investment analysts, entitled "Specialty Property: Strong Results When Placement Rates Return to Lower Levels: Targeted long-term Operating ROE of 20-25%," the slide shows historical loss ratios from 2006 through 2011 of 33% to 43% and a "steady-state estimate" of future loss ratios of 38% to 44% -- loss ratios well below and profit provisions well above those in American Security Insurance Company Florida LPI rate filings.[1] We urge the OIR to require QBE to provide the actual internal loss ratio, expense and profit targets and projections it establishes for LPI to allow the OIR to verify the accuracy of the representations made in the Praetorian rate filing.

Commissions and General Expenses

Praetorian proposes expenses provisions of 11.0% for commissions and 11.5% for general expenses. The prior filing had the same provision for general expenses and a 15% provision for commissions.

As with the prior filing, Praetorian has provided no substantive support for these proposed expense loads and the proposed expense loads continue to bear no relationship to historical experience or common sense. Exhibit 13A shows a five-year average of 4.7% for commission

[1] http://files.shareholder.com/downloads/AIZ/2268695612x0x555914/f9878e6b-e08d-41da-b89a-f6d6b907ebc1/AIZ_JPM-Peninger_Presentation_3.29.12_Revised_Final.pdf

and a five-year average of 9.4% for general expenses with general expenses declining in each of the past five years from 2007 to 2011 from 11.8%, 10.3%, 8.1%, 7.3% and 2.9%, respectively.

Exhibit 13A also shows expense provisions form a 2009 American Security IC rate filing with the Praetorian selected factors. No explanation is provided for the selections or why the ASIC filing is relevant. Consequently, the rate filing has no empirical or actuarial support for the proposed commission and general expense loads and Praetorian has failed to meets its burden for approval of the filing.

In its actuarial memorandum, Praetorian provides a general discussion of expenses. This discussion is noteworthy because it does not include a single number or reference to the proposed provisions. Consequently, the discussion provides no support for the proposed commission and general expense provisions.

The expense discussion is also noteworthy for the confused and illogical discussion of expenses. As background for the discussion of the Praetorian expense "justification," it is important to describe the LPI insurance policy and process. Mortgage servicers are required to ensure continuous insurance coverage on the properties serving as collateral for the loans in their servicing portfolios. To monitor the presence of voluntary insurance on these properties, servicers track the loans for required insurance. Servicers are paid by mortgage owners, like Fannie Mae, to perform such insurance tracking. In fact, the mortgage servicers contract out the insurance tracking activity to vendors and these vendors are either the insurance companies providing LPI or affiliates of the insurance company (as in the case of QBE FIRST). Insurance tracking – including loading insurance information into a database, sending letters to borrowers if required evidence of insurance is missing, customer service and call center activity related to tracking of insurance – is the servicer's responsibility. The servicer would incur these expenses even if no LPI coverage was ever placed on a borrower's property. Consequently, the costs of insurance tracking are not reasonably included in the LPI rates. But the expenses associated with insurance tracking are included in the financial statements of LPI insurers – either as expenses incurred by the insurer (like ASIC) or paid to an affiliate (like Praetorian to QBE FIRST).

The expenses associated with administering the LPI policy should be modest, particularly in comparison to homeowners insurance. LPI is a group policy issued to a servicer. Praetorian testified in July that the number of clients/servicers for QBE Specialty and Balboa IC totaled around only 30 or less. The LPI insurer issues coverage upon notification of the mortgage servicer / insurance tracking vendor. The LPI insurer bills the mortgage servicer periodically for coverage issued. It is not reasonable that these expenses are as high as proposed by Praetorian.

The OIR must examine the actual expenses incurred by Balboa IC, QBE Specialty and QBE FIRST by functional activity to meaningfully evaluate the reasonable expenses associated with issuing and administering an LPI policy as opposed to expenses associated with a variety of other activities not reasonable included in LPI rates.

We now turn to the Praetorian expense discussion.

> These programs must have the ability to process a tremendous volume of transactions accurately and within a very short time frame. While voluntary programs solicit insurance products to willing customers, most call center interaction within a lender placed program involves an uncooperative mortgage borrower.

The tremendous volume of transactions is those associated with insurance tracking, not the issuance of coverage under the master policy. The filing states there are about 109,000 "policies in force." While this is a substantial number of coverages issued under the master LPI policy, it is simply not a "tremendous volume of transactions . . . with a short period of time." Voluntary homeowners insurers – who have to perform far more activity to issue and process a policy because of individual property underwriting – routinely handle this volume of policies. In addition, Praetorian's blaming the victim strategy – "uncooperative mortgage borrower" – is misplaced. Testimony at public hearings by LPI insurers reveals that 10% to 20% of LPI is falsely-placed and some borrowers are retroactively charged for a year or more of LPI because of poor tracking and late notice by LPI vendors. The poor performance of mortgage servicers and their LPI vendors has been recognized in the foreclosure settlement between state attorneys general and large servicers and in proposed rules by the Consumer Financial Protection Bureau.

> This environment requires additional training and call center support not required by voluntary programs. For example, these specialized calls typically last longer and more frequently require supervisor participation. Recently, we implemented a process called "close the loop," where the customer support center actively follows-up with borrowers to confirm any insurance information provided by borrowers after placement has occurred. Once lender place insurance is ordered, the program must update the servicing system of the lender impacted. This requires the program to maintain the ability to update various loan servicing platforms at all times, necessitating constant technology upgrades.

Praetorian continues to mix the insurance tracking and LPI insurer roles in the discussion. Following up with a borrower for evidence of insurance is the role of the insurance tracking vendor, not the LPI insurer. Further, the claim that "this environment requires additional training and call center support not required by the voluntary market" is completely without support or logic. In the voluntary market, an agent or call center representative must answer questions about coverages and coverage options – including coverages not included in LPI. The agent or call center representative must inquire of the customer all sorts of information not required by the LPI insurer.

Finally, the Praetorian explanation again shows how servicer responsibilities are transferred to the LPI insurer with the associated expenses inappropriately included in LPI rates. Praetorian explains that "once lender placed insurance is ordered, the program must update the servicing system of the lender impacted." It makes no sense to include the costs of a servicer updating its servicing system to note that it has ordered LPI as anything other than a servicer expense. The servicer updates this information to ensure it complies with the mortgage owners' requirements and to be able to bill the borrower for amounts the mortgage servicer has paid to the LPI insurer. The expenses for these activities should be borne by the servicer and not included in LPI rates.

> QBE FIRST generally views expense as falling into two categories: 1) expenses associated with tracking mortgage loan portfolios to identify mortgage collateral without required insurance; and 2) expenses associated with placing insurance on those loans without required coverage and managing that insurance once placed. Expenses falling into the first category essentially represent loan tracking expenses not included in our Florida lender placed insurance rate development. However, the second category represents those expenses necessary to order required insurance, bill the insurance, address borrower issues related to the insurance, and generally manage the insurance. All expenses falling into the second category are properly included in the development of lender placed insurance premium rates.
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> This approach to expense accounting is consistent with recent industry guidance regarding expenses associated with lender placed insurance program.

Praetorian correctly explains the distinction between servicer and LPI insurer responsibilities and expenses. But, Praetorian has provided no evidence or support to demonstrate that it is, in fact, not including the inappropriate expenses in its proposed expense provisions. Simply stating it does not include inappropriate expenses is not evidence or support in a reverse-competitive market in which mortgage servicers can demand considerations for selecting a particular LPI provider.

> As a matter of standard business practice, lender placed insurance programs pay commission to intermediaries/aggregators, who acquire and manage small- to mid-size mortgage services, and to agencies controlled or owned by mortgage servicers. The following illustrate the services these parties provide to lender placed insurance programs in addition to those services typically provided by commercial insurance brokerages:

As a preliminary comment, commissions to servicer-affiliated agents or brokers should not be included in rates as these payments are simply considerations to the servicer. These servicer-affiliated agents typically have one LPI client – the affiliated servicer – and the servicers they perform are those of vendor management for non-LPI services.

> • Administration and management: Payees, particularly intermediaries/aggregators, provide client-specific services by handling some borrower communication and assisting with the management of some loan servicing platforms.

Praetorian describes the role of an administrator – an entity performing services on behalf of the LPI insurer. In the case of Praetorian, QBE FIRST – an affiliate of Praetorian – performs these tasks. Praetorian pays QBE FIRST for these services and, to the extent any of these expenses are actually associated with the provision of LPI, the expenses should be included as general expense and not commission in rates.

> • Quality assurance and auditing: Payees confirm the accuracy of lender placed insurance rates, as installed within the lender servicing environment and monitor the lender placed insurance program to ensure proper rates are charged at all times.

This activity is the responsibility of the client – the mortgage servicer's vendor management activity. It strains credulity to argue that an insurance agent is paid by the insurer to verify that the insurer has calculated premiums correctly.

> • Claims support: Payees assist in reviewing claims performance and reporting claims activity to the named insured loan servicer.

Again, reviewing the performance of the LPI insurer / LPI vendor is the responsibility of the mortgage servicer who has entered into the agreements with the LPI insurer / LPI vendor and who has the authority, pursuant to those agreements, to audit its vendors.

> • Letter management: Payees participate in the development, testing, and revision of necessary letter text and other borrower notices.

The vast majority of correspondence with borrowers is related to providing evidence of required insurance – an insurance tracking activity that is the responsibility of the servicer. "Letter management" is not a reasonable expenses included in LPI rates.

> • Compliance: Payees act as a liaison between the insured mortgage servicer and the lender placed insurance with respect to lending laws, such as RESPA, investor guidelines imposed by public and private investors and guarantors, and assist in communicating the impact of those lending regulations on lender placed insurance.

Again, the responsibility for the mortgage servicer's compliance with RESPA, investor guidelines and other requirements **of the mortgage servicer** is with the servicer and any expenses associated with such activity are not reasonably included in LPI rates and do not justify payment of a commission by the LPI insurer

> • Planning and forecasting: Payees communicate loan platform activity necessary to anticipate workflow demands and adjust to dynamic loan asset management (for example, the sale and acquisition of blocks of loans).
> • Implementation: Payees coordinate the installation of new programs and new services, including the preparation of detailed business requirements necessary to support such efforts.

In the earlier paragraph, Praetorian clearly described and demarcated the difference between servicer and LPI insurer responsibilities. Here, as with the preceding bullet points, Praetorian contradicts that clear, earlier statement by ascribing a variety of servicer vendor management activities to LPI as an activity of the agent. **What is clear from the Praetorian expense discussion is that Praetorian's simple assertion of not including inappropriate expenses in the proposed rates has no credibility.**

> Exhibit 13A displays both historical and prospective expenses. The selected expenses are based on future anticipated expenses and industry data, consistent with the expense detail provided above.

This statement is gibberish. No expense detail is "provided above" and there is no explanation of how the "selected expenses based on future anticipated expenses and industry data" is determined.

> The combination of the Balboa business with the QBE Specialty business, coupled with the expenses resulting from the QBE acquisition of the substantially all of the Balboa assets contemplates the payment of reasonable commissions to unaffiliated business partners. The commission expense used in this filing reflects the existing combination commission obligation of Praetorian and the expected commissions necessary to acquire new business commensurate with industry standards.

It is unclear how the Praetorian business could "contemplate" any non-trivial amount paid to unaffiliated business partners or how the proposed 11% commission load reflects existing obligations or future requirements. The bulk of the Praetorian business will come from Bank of America, which entered into a ten-year exclusive deal with QBE after selling Balboa to QBE. No commission is warranted on that business. No commission is warranted for servicer-affiliated producers. In fact, some servicers are ceasing to take commissions.

If Praetorian has provided any evidence of reasonable commission obligations – as opposed to payments for administrative services as the company described above – we request copies of any such documentation submitted by Praetorian to the OIR.

Scheduled Rating Rate Impact

Exhibit 24 indicates that Balboa is currently charging its clients 24.9% below the filed rates through scheduled rating. But, under the proposed rates, Balboa clients will not be seeing an average 8.2% scheduled rating surcharge. This represents a 44% increase in rates due solely to changes in scheduled rating credits – an implausible result.

Scheduled Rating Plan

Scheduled Rating is a mechanism for the insurer to modify the base rates – and, consequently, premiums charged – by up to + / - 25% based on characteristics of the loan portfolio covered by the LPI. The proposed schedule rating plan includes:

- 30+ days contractual delinquency measured as a % of total active mortgage loans (+ / - 15%)
- Foreclosure loans measured as a % of total active mortgage loans (+ / - 10%)
- Named Insured choice to purchase coverage for the lesser of value of improvements for unpaid principal balance ((+ / - 10%)
- Operating Expenses Associated with Lender Placed Program (+ / - 15%)
- Loss History for Hazard Insurance Protection (+ / - 15%)
- Concentration of exposures in high risk (catastrophe prone) areas (+ / - 15%)
- Average Property Values (+ / - 15%)

Scheduled Rating should not be permitted or approved because it allows the insurer to arbitrarily change the rate. For “risk characteristics” that are objectively measured – delinquent loans, foreclosure loans, basis for coverage – a rating factor should be introduced if there is an objective relationship to risk of loss. In earlier filings, Balboa had a rating factor for loans in foreclosure.

Scheduled rating based on average property values and concentration of risk in catastrophe prone areas is inappropriate because those characteristics are already captured in proposed rating factors. The filing proposes a complex rating factor for amount of coverage and includes rating territories with extremely high relativities for cat prone territories.

Scheduled rating based on operating expenses is inappropriate because it is arbitrary and because operating expenses for LPI – as opposed to insurance tracking – are minimal. Given that operating expenses for LPI should be in the range of 5%, it is unreasonable to include a provision to change rates up to + / - 15% based on a subjective evaluation of operating expenses associated with a particular servicer. In addition, this factor is particularly unreasonable because affiliates of Praetorian are likely the contractors selected by the mortgage servicers to perform the insurance tracking and related services. In essence, scheduled rating could be used to reward servicers who select QBE/Balboa for non-LPI mortgage servicing activities.

Finally, scheduled rating for loss history is inappropriate for LPI because there is no reasonable opportunity for mortgage servicers to engage in LPI loss mitigation. Unlike insureds in other lines of insurance subject to scheduled rating who can employ loss mitigation strategies to reduce losses, mortgage servicers cannot and do not employ loss mitigation strategies for LPI. Properties insured are only those without sufficient evidence of insurance; the mortgage servicer identifies the properties to be insured under the LPI policy, but does not select the properties to be insured.

Ignored Indication

The filing shows an indicated rate change of -23.8%. Yet, Praetorian selects a rate change of only -17.0%. There is no basis to approve proposed rates so much higher than the company's own indicated rates, let alone approve rates so much higher than reasonable rates.

Balboa IC and QBE Specialty Combined vs. Separate Experience

The premium and loss data, including premium and loss trend data, are presented on a combined basis for Balboa IC and QBE Specialty. The combination of the data may skew results, particularly for trend analysis and loss development. The data should be presented separately for Balboa IC and QBE Specialty to allow review of individual company data for anomalies for individual company experience or combined experience.

QBE Rate vs. Balboa

The filing claims that the current average QBE Specialty rates are 10.5% higher than the Balboa rate level. The filing asserts the rate differential was calculated by rerating QBE Specialty policies using current Balboa IC rates (Exhibit 5C). No support or evidence is provided for this assertion, which has impact on the premium at current rate level analysis. Data in the filing do not support this assertion of rate differential. Exhibit 24 – Overall Premium Impact Calculation – shows the current number of property risks and total premium for Balboa IC and QBE. The average premium for Balboa IC is $352,100, 194 / 87,678 equals $4,015.83. The average premium for QBE Specialty is $108,558,904 / 26,432 equals $4,107.10. The average QBE premium is only 2.3% greater than the average Balboa premium.

REO vs. non-REO

Real-Estate Owned (REO) is property that has been foreclosed and is now owned by the lender/investor. LPI premiums for REO properties cannot be passed on to the borrower because there is no longer a mortgage or a borrower involved. LPI premiums are paid by the servicer and passed through to the lender/investor.

It is logical that there is different loss experience for REO and non-REO properties. REO properties are more likely to be vacant and more likely to be in neighborhoods with other foreclosed properties. Earlier Balboa filings partially recognized this issue by having a rating factor for type of occupancy with significantly higher rates for vacant properties. Prior to 2010, the rate for vacant properties was 3.05 times the rate of owner-occupied properties. In 2001, the vacant occupancy rate became 1.54 times the rate of owner-occupied properties. The Praetorian filing eliminates this rating factor.

The analysis of loss experience should be performed separately for REO and non-REO properties because the loss experience of REO properties is likely to be worse than that of non-REO properties. There should be different LPI rates for REO and non-REO properties, so borrowers in non-REO properties are not charged excessive rates to subsidize the rates of REO properties.

Age of Home Rating Factor

The age of home rating factor has a massive impact on premium. The relativities are 0.683 for homes zero to 14 years old, 1.051 for homes 15 years and older and 1.000 for "not supplied." For properties older than 14 years, the LPI premium is 54% higher than homes 14 years or younger. The age of home factors are the same for non-hurricane and hurricane perils. It seems unlikely that the age of home factor is the same for non-hurricane and hurricane perils.

Further, the use of only three relativities – 14 or less, 15 or more, unknown – is crude and results in massive rate dislocation around the age of home cutoff of 14. The filing provides no analysis of age of home by categories other than three relativities, so there is no way to evaluate if additional age of home relativities may be reasonable and justified.