Comments of the Center for Economic Justice

To the NAIC Creditor-Placed Insurance Model Act Review Working Group

June 7, 2017

CEJ writes to express our concern with proposals during today's working group to abandon revision of the current Creditor-Placed Model Act and to only develop a separate model pertaining only to Lender-Placed Home insurance (LPI Home). We explain our opposition to this proposal, provide some additional comments on blanket coverage and respond to some of the industry comments.

Regardless of Whether the Working Group Decides to Develop a New Creditor-Placed Insurance Model From Scratch or Revise the Current Model, The New Model or Models Should Apply to LPI Auto and LPI Home.

As CEJ discussed during today's call, LPI Auto and LPI Home are different products, but share many similar characteristics in product design, disclosure, rate and form filing and consumer protection needs. Both products are sold in reverse-competitive markets in which LPI insurers vie for creditor or servicer business by offering considerations or kickbacks in the form of profit-sharing and free or below-cost services. Both products are generally sold as group master policies from which individual coverage is issued as needed. Both products involve required disclosures to consumers prior to force-placement. Both products have similar rate and form consumer protection requirements.

While there may be places in a LPI model that require distinction between LPI Auto and LPI Home, the similar consumer protection needs indicate that regardless of whether the working group decides to develop a new LPI model from scratch or work off the current model, the new model or models should apply to LPI Auto and LPI Home. Even if there is a need for separate LPI Auto and LPI Home models – which we doubt – then they should be developed together to ensure consistent consumer protections and regulatory treatment.

The current model must either be retired – because it is not used by states and fails to provide even minimal consumer protection – or be substantially revised. The current model has been adopted by five or fewer states and fails to reflect any of the consumer protections memorialized in regulatory actions over the past five years. For example, <u>it would make no sense to develop one LPI model that prohibits a variety of kickback schemes while leaving in place another model that memorializes such schemes.</u>

Even if the working group were to decide to start "fresh" in developing a new LPI model, that fresh start should also apply to LPI Auto. We have great concern that industry proposals to leave the current model as is will lead to a failure to stop what former New York Superintendent Lawsky described as the "kickback culture" of LPI markets.

Blanket Coverage

Unlike LPI, which has a clear and objective definition, blanket coverage is an ill-defined form of LPI. LPI is insurance placed by a creditor or servicer to protect the vehicle or property serving as collateral for a loan. Blanket coverage generally refers to LPI for which there is no insurance tracking and, consequently, the premium is not based on individual coverages issued under master policy, but based on aggregate exposure (like total unpaid principal balance or total coverage of the loan portfolio). Blanket coverages are generally single-interest coverages, meaning the creditor or servicer is the sole named insured.

Industry wants all blanket coverages exempt from regulation, even if there is separate charge to the borrower to reimburse the creditor or servicer for the coverage. We strongly oppose this proposal because it fails to recognize the consumer protection issues of a reverse competitive market.

As the definition of reverse competition in the proposed model makes clear, a creditor or servicer who makes a separate charge to the borrower (or in the case of default, to the investor who owns the loan) to recoup LPI premium paid by the creditor or servicer to an insurer has the market power and incentive to seek considerations from the LPI insurer for placing the business with the LPI insurer. The creditor or servicer has no incentive to use this market power to force down LPI rates because doing so would limit the LPI insurer's ability to provide considerations to the creditor or servicer. This is precisely the situation we have seen with both LPI Auto and LPI Home as evidenced by very low loss ratios and a variety of kickback schemes.

In contrast, a creditor or servicer who purchases blanket coverage without assessing a separate charge to the borrower has every incentive to seek out the lowest LPI rates because the LPI premium becomes another cost of servicing the loan and competition to offer the lowest rates will drive the creditor or servicer to seek the lowest LPI premium – just as the creditor or servicer seeks out the lowest cost / most capable servicing software/data systems or payment processing systems.

By limiting the scope of the proposed LPI model to only that LPI for which a separate charge is made to the borrower, the model focuses solely on that type of LPI for which a competitive market does not operate. Even if we assume that a result of the model would be that lenders shift the cost of the blanket coverage from the "nominal" up front charge to a slightly-higher interest rate, no consumer or lender are harmed because all lenders will be in the same situation and consumers, at worst, will be paying the same amount in a different form.

On the other hand, there are two certain results of a model which is limited to LPI for which a separate charge is made to the borrower – regardless of whether the coverage is traditional or "blanket." First, no definition of "blanket coverage" is needed because the model is crystal clear about what types of LPI are covered and what types are excluded. Second, the potential harm from reverse competition is eliminated because the lender and LPI insurer are now the participants in a normally-competitive market.

Brief Response to Industry Comments

There are issues of opinion – there should be a separate model for LPI Home – and there are issues of fact – the proposed model will lower, not raise, mortgage costs for borrowers, will not force servicers to perform insurance tracking themselves, servicers are paid for insurance tracking by investors, servicers are required to perform insurance tracking for a variety of reasons, LPI insurers do not perform insurance tracking for exposure management.

Regarding the role and operation of creditors or servicers and LPI insurers regarding insurance-related activities of a creditor or servicer, the industry comments reflect a profound misunderstanding of the issues and make bizarrely misleading claims. Consequently and not surprising, industry offers not one iota of evidence in support of these assertions. The industry claims regarding insurance tracking are easily disproved with actual evidence.

Below are just the first several false claims made in the industry trades' letter (cited in ***bold italics)*** and an explanation and evidence why the claim is in error.

1. ***The significantly revised draft of the Model Act would harm many mortgage borrowers by increasing mortgage costs***

Fact: By eliminating kickbacks to servicers and better regulating LPI rates, the proposed model will lower the cost of LPI and, consequently, mortgage costs, for some borrowers with no effect on other borrowers.

2. ***Affected mortgage originators and servicers would have to take on insurance tracking, a task that is more appropriate for LPI insurers, and which would be to the detriment of consumers as detailed below.***

Fact: The issue is not who does tracking, but who pays for it. The proposed model has no effect on who does the tracking, only who pays for it. A servicer who contracts out for tracking will continue to do so because investor/owners required the servicer to perform the tracking and because LPI vendors are able to provide the tracking services more efficiently than the servicer could do itself. Eliminating a kickback will not change the basic economics of performing tracking in-house or outsourcing.

3. ***For clarity, servicers are required to ensure coverage is in place on all properties at all times. To accomplish that, servicers contract with insurance companies to provide coverage on their entire portfolio via automatic issuance. Since the insurance company assumes the risk on the servicer's entire portfolio upon contract execution, the insurance company needs to manage that risk via the exposure management process.***

Fact: LPI insurers manage the risk via underwriting the portfolio, as evidenced by scheduled rating worksheets which deal only with loan portfolio characteristics.

4. ***Servicer has no need to actually track insurance coverage***

Fact: The servicer has to track insurance not only to ensure continuous coverage, but to pay premiums for voluntary coverage out of escrow. Investors/owners pay servicers for tracking.

5. ***LPI insurer needs tracking info to manage its LPI risk***

Fact: Properties come and leave the portfolio so today's LPI coverages are not tomorrow's or next weeks. LPI insurers manage risk by underwriting the portfolio of loans – location, quality, escrow v non-escrow. Evidence of this is provided by scheduled rating worksheets.

6. ***Servicer not responsible for tracking,***

Fact: Servicers are responsible for tracking as set out in statute (Flood), regulation (CFPB) and servicing contracts (Fannie Mae) Incredibly, the industry comments even state this – stating that servicers need to track in order to comply with CFPB rules: *The following activities relate directly to insurance tracking, and all are required for the LPI insurer to comply with its obligation to the servicer and for the servicer, through the LPI insurer, to comply with the consumer protection requirements set forth in the CFPB's Regulation X*: Industry makes the absurd argument that because the servicer outsources one of its servicing obligations for insurance tracking, this outsourcing somehow creates a requirement for the LPI insurer.

7. ***Some have claimed that holders of mortgage loans pay insurance tracking costs to servicers and, consequently, that the inclusion of tracking costs in the calculation of LPI premium would have the borrower being charged twice for insurance tracking. This claim is false.***

Fact: Fannie Mae makes the statement that under the current LPI system, they pay twice. From a 2012 Fannie Mae RFP for LPI:

> The existing system may encourage Servicers to purchase Lender Placed Insurance from Providers that pay high commissions/fees to the Servicers and provide tracking, rather than those that offer the best pricing and terms to Fannie Mae. Thus, the Lender Placed Insurers and Servicers have little incentive to hold premium costs down. In addition, Fannie Mae is often paying twice for Insurance Tracking services; once via the servicing fee that Fannie Mae pays to Servicers, and again via the Lender Placed Insurance premiums, since those premiums may include or subsidize the costs of tracking services (to the extent that insurers are providing such services).

8. **A LPI insurer's tracking of whether required insurance is in place on all properties in a loan portfolio has nothing to do with a mortgage servicer's tracking a mortgage loan portfolio for loan management purposes.** ***The two tracking regimes serve very different purposes***

Fact: There are not two servicing systems for "loan management" versus tracking continuous insurance coverage. The servicer's servicing system of record, which is updated by the insurance tracking vendor if insurance tracking is outsourced, handles all the insurance-related servicing functions. The LPI vendor updates the servicer's the servicer's system of record for a variety of insurance purposes: The role and responsibilities for the servicer regarding insurance are clearly set out in the text *Resident Mortgage Lending*, 6th Edition. Pinkowish writes that for a loan servicer to fulfill its responsibilities, the servicer will typically have separate departments to perform five essential functions:[1]

1. Payment Processing
2. Loan Accounting
3. Escrow Administration
4. Customer Service
5. Delinquency and Collection

Pinkowish describes the escrow administration department activities related to insurance and the role of LPI.[2]

> The escrow administration department ensures the protection of the security interest by determining whether adequate coverage is in place and is current with a mortgagee-payable clause for required insurances or credit guarantees. This may include the following: hazard, flood, private mortgage, FHA, VA, or other state/federal housing agency insurance or credit guarantee. It monitors in a similar manner the status of real estate tax payments for all towns in which the servicer has loans.
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> The escrow administration accomplishes this in one of three ways: it either collects funds from the borrower and disburses payments for all required taxes and policies; it monitors the status of tax payments and required policies, "force-placing" them if it

[1] Pinkowish, p. 502.
[2] Pinkowish, pp. 507 - 8.

receives notification of cancellation; or, a less common approach is to take out a blanket or umbrella insurance policy – a mortgage impairment policy – to cover any losses sustained as a result of individual loan tax liens or insurance lapses of coverage. This department may also inspect property repairs (if the damage was large and affects the actual structure of the security) before releasing an insurance claim payment to the mortgagor, adhering to lender or investor requirements.

9. ***Because LPI is placed automatically – with little or no underwriting – LPI insurers must be able to manage their risk contemporaneously with the change in their LPI risk profile associated with the placement of LPI. LPI insurers engage in insurance tracking to manage this risk.***

Fact: In a cover letter to its 2013 Florida LPI rate filing, Assurant's American Security Insurance Company makes clear the servicer is responsible for detecting lapses in coverage and for directing the LPI insurer to issue LPI coverage. The automated nature of LPI placement is a function of the servicer automating the direction to the LPI insurer to issue coverage.

Tracking all loans in a portfolio does not manage the risk of small percentage which requires LPI. That risk is managed by keeping track of properties actually covered – 2-3% of properties in the loan servicing portfolio and by underwriting the risk and exposure characteristics of the loan portfolio – such as delinquency rates and percentage of loans escrowed vs. non-escrowed

Further, if tracking essential, then there would be no LPI products for which there is no tracking – and there are. And there would be no insurers offering LPI without tracking – and, again, there are.

Conclusion

It is essential that any new or revised LPI model law prohibit the costs of insurance tracking from inclusion in the LPI rates. Absent a strict exclusion, LPI insurers will continue to provide kickbacks to creditors or servicers at the cost of borrowers charged for LPI. Absent a strict exclusion, LPI insurers will continue to shoe-horn these kickbacks into whatever exemptions to kickback prohibitions are included.