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Comments from the Center for Economic Justice

To the NAIC Lender Place Insurance Model Act Working Group

November 3, 2020

The Center for Economic Justice (CEJ) offers the following comments on the draft NAIC Lender-Place Insurance Real Property Model Act.

I. Summary of Comments

There are four major problems with the exposure draft.

1. It fails to recognize and acknowledge the reverse-competition in lender-placed insurance (LPI) markets that has led to consumer abuses by LPI insurers and mortgage servicers[1] and that drives the need for enhanced consumer protections.

2. It fails to explicitly prohibit the inclusion of tracking expenses in LPI rates and premium charges. Insurance tracking activities and related expenses are the responsibility of the servicer for which the servicer is paid by the owner of the mortgage. By including tracking expenses in LPI rates, the entire costs of tracking for all borrowers is assessed on the small percentage of borrowers who are force-placed and massively inflates the premium through inclusion of expenses unrelated to the provision of insurance.

3. It fails to prohibit single-interest LPI for real property.

4. It establishes an absurdly low minimum loss ratio.

5. It includes an invitation to kickback abuse with inclusion of "implementation expenses."

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[1] Servicers are the entities who administer or service mortgage loans after the loan is originated. See Pinkowish, *Residential Mortgage Lending Principles and Practice,* Sixth Edition at page 501: After closing a mortgage loan, the next step in the residential lending process involves servicing . . . . All residential mortgage loans require servicing. Loan servicing includes the responsibilities, functions and day-to-day operations that an organization performs after the closing and over the term or repayment of loan."
In most cases, servicers are separate entities from the owners of mortgage loans. Some lenders originate, maintain ownership and service the loans they own, but most mortgages are owned by either investors (through mortgage-backed securities) or by federal agencies or quasi-public entities, like Fannie Mae, Freddie Mac, Ginnie Mae or the Veterans Administration and are serviced by others for a fee – the servicing fee.
In our comments, "servicers" refers to any entity that services a mortgage loan whether or not that entity is the owner of the mortgage.

The current draft does not reflect an objective review of the LPI product or market and is not supported by evidence or reason. We have previously submitted our suggested revisions in redline.

In October 2018, CEJ made a presentation to the Florida Office of Insurance Regulation (FL OIR) discussing the proposed NAIC LPI model. That presentation, attached, to these comments, is attached and documents the evidence in support of CEJ's positions.

We supplement that presentation by addressing comments raised during the October 19, 2020 call.

II. Tracking Expenses Must Be Excluded From LPI Rates

Servicers are responsible for, and are compensated by mortgage owners, for insurance tracking. Tracking expenses or insurance tracking refers to a variety of servicer responsibilities and related activities to ensure continuous insurance coverage of the property serving as collateral for the loan. Insurance tracking is part of the escrow administration function of servicing[2] and includes

- Initially entering insurance information obtained at closing into the mortgage servicing system of record – the database used to track a borrower's mortgage.

- As required by statute or regulation or requested by borrowers, establishing escrow accounts for borrowers to collect funds from mortgage payments for insurance and disburse those funds to the borrower's insurer for policy renewal.

- Gathering information from insurers, agents and borrowers regarding evidence of required insurance and updating the insurance information in the mortgage servicing system of record.

- Corresponding with borrowers regarding missing evidence of required insurance and warning of LPI placement if the evidence is not provided.

- Maintaining call and mail centers or other means to accept and respond to borrower questions and communications regarding required insurance and why insurance was force-placed.

While is it typical for servicers to contract out some or all of these insurance tracking functions, these functions are the servicer's responsibility, for which the servicer is compensated. This fact is supported by extensive evidence, including:

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[2] Pinkowish at pages 507: "The *escrow administration function* ensures the protection of the security interest by determining whether adequate coverage is in place and is current with a mortgage-payable clause for required insurance or credit guarantees."

- Federal statutes and regulations;
- Fannie Mae and Freddie Mac servicing requirements;
- Texts on mortgage lending and mortgage servicing; and
- Common sense.

The FL OIR presentation quotes from the Fannie Mae Standard Mortgage contract to demonstrate that the need for insurance tracking follows from the mortgage contract requirement of the lender to maintain insurance.

The largest owners of mortgages – and the largest users of mortgage servicers – are the quasi-public agencies Fannie Mae and Freddie Mac. Fannie and Freddie contract with servicers to service the mortgages that Fannie and Freddie own and pay the servicers to do so. Fannie and Freddie have extensive servicing guides which set out the responsibilities of their mortgage servicers for insurance tracking. For example, the Fannie requirements are found at Section B-2-01[3] and B-6-01[4] of the Fannie Servicing Guide and are excerpted in the FL OIR presentation.

Federal law and regulations also specify the lender/servicer responsibility to ensure insurance is and remains in place. The FL OIR presentation cites the Flood Disaster Protect Act provisions requiring lenders to ensure flood insurance is in place and maintained for the term of the loan if the property is located in a designated flood hazard area. [5]

Regulation Z (12 CFR 1024.37), promulgated by the Consumer Financial Protection Bureau and excerpted in the FL OIR presentation describes the requirements for a servicer regarding force-placed insurance and clearly indicates that insurance tracking is the responsibility of the servicer. The regulation sets out requirements of the servicer for notifying a borrower regarding missing insurance and the various steps a servicer must take before the servicer can assess a charge for lender-placed insurance.[6]

The textbook *Residential Mortgage Lending Principles and Practice, Sixth Edition*, describes the responsibilities of mortgage servicers, how servicers are paid for activities and how insurance tracking is part of the escrow administration function of servicers.[7]

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[3] https://servicing-guide.fanniemae.com/THE-SERVICING-GUIDE/Part-B-Escrow-Taxes-Assessments-and-Insurance/Chapter-B-2-Property-Insurance-Requirements/B-2-01-Prop-Ins-Reqs-Applicable-to-all-Prop-Types/1040884241/B-2-01-Property-Insurance-Requirements-Applicable-to-All-Property-Types-12-12-2018.htm?touchpoint=guide

[4] https://servicing-guide.fanniemae.com/THE-SERVICING-GUIDE/Part-B-Escrow-Taxes-Assessments-and-Insurance/Chapter-B-6-Lender-Placed-Insurance/B-6-01-Lender-Placed-Insurance-Requirements/1041095611/B-6-01-Lender-Placed-Insurance-Requirements-10-14-2015.htm?touchpoint=guide

[5] 42 USC 4012(b)1

[6] https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1024/37/

[7] See Pinkowish at pages 506 and 509. See also National Consumer Law Center, *Mortgage Servicing and Loan Modifications, First Edition.*

Common Sense

It is also common sense that insurance tracking is a servicer responsibility and the expenses for insurance tracking are not reasonably included in LPI rates and premium:

- By including tracking expenses in LPI rates and premium, the costs of tracking are assessed on the small percentage (1% to 4%) of borrowers who are force-placed. Yet the insurance tracking activities touch all borrowers in the portfolio.

- If all borrowers maintained required insurance, the servicer would still be required to perform insurance tracking to ensure the coverage was in place and to disburse escrow for premium renewal as needed. Yet, in this situation, there would be no premium for LPI because no coverage under the master policy would be required. And if the costs of insurance tracking were included in LPI rates, then the insurer would be on the hook to provide all these services without compensation.

- If insurance tracking is an insurance expense because it is necessary for the insurer to be able to provide LPI as claimed by industry, then there could be no blanket LPI coverage for which no tracking is performed. Yet, such blanket LPI products are common.

- If insurance tracking is an insurance expense because it is necessary for the insurer to be able to provide LPI as claimed by industry, then there could be no LPI coverage provided in New York or Rhode Island since both states have directed LPI insurers to exclude tracking expenses from LPI rates.

The cost of insurance tracking is significant. Permitting insurance tracking expenses in LPI rates dramatically inflates LPI rates and unfairly penalizes the most financially-vulnerable borrowers.

Servicers typically outsource insurance tracking to third parties – the LPI insurer or the LPI insurer's managing general agent. The insurers and MGAs providing the service typically charge a fee for that service. The fee is expressed as an amount per tracked loan per month. This fee charged by the LPI insurer or MGA is far below the actual cost of providing that service. The losses incurred for insurance tracking by the LPI insurer are recouped through inflated LPI rates. Stated differently, while the servicer may pay $X in LPI premium, the net cost to the servicer is a fraction of $X because the insurer has kicked back part of that premium in the form of below-cost services.

Attached to these comments is an affidavit in a LPI lawsuit in which the defendant lender's loan service manager states that the fee for insurance tracking paid to the LPI insurer is substantially less than the market cost of those services:

> 18. The OSC Agreement includes a comprehensive schedule of services and administrative functions that OSC agreed to provide the Bank with respect to its loan portfolio FPI processes. In consideration of these services, the OSC Agreement includes a fee schedule imposing (i) a monthly fee of $0.28 for each loan monitored within the portfolio; (ii) the actual cost of postage and delivery fees incurred in connection with borrower correspondence regarding an FPI event; and (iii) an hourly rate of $150.00 for tasks that require additional programming support.
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> 19. The Bank's loan portfolio subject to these loan monitoring services consists of approximately eighteen thousand (18,000) loans, although that figure fluctuates.
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> 20. Following the OSC Agreement Amendment, Affiant investigated the fees charged by comparable vendors as OSC. Affiant determined that the marketplace for insurance-portfolio tracking services can be broadly characterized into two tiers of service. In the higher tier, the tracking services are such that the Bank is not necessary for virtually any step of the process. From my investigation, a reasonable range of cost for higher tier services is approximately $0.80 to $0.90 per loan per month. In the lower tier, the services provided require substantial interaction and effort by bank employees. From my investigation, a reasonable range of cost for lower-tier services is approximately $0.40 to 0.50 per loan per month.

This affidavit not only documents one example of the LPI insurer kickback to the lender in the form of the below-cost provision of tracking services, but also acknowledges that tracking is a lender/servicer responsibility and that the lender/servicer can obtain those services from providers in the market separate from the provision of LPI.

The lender represented in the affidavit has a relatively small portfolio of serviced loans – around 18,000. In contrast, top mortgage servicers have servicing portfolios of hundreds of thousands or millions of loans. For perspective, there are over 50 million mortgage loans outstanding. In my experience, the fees charged for insurance tracking are far lower than $0.28 per loan per month for larger servicers. Testimony in the 2012 New York Department of Financial Services investigative hearing on LPI revealed insurance tracking fees of zero to a few cents per loan per month.

The table below shows the significant impact of the tracking kickback assuming:

- a loan portfolio size of one million;
- a tracking fee charge of $0.10 per loan per month;
- actual tracking costs of $0.50 and $0.90 per loan per month;
- an LPI placement rate of 1.56% -- the actual placement rate reported by Assurance in its second quarter 2020 earnings release supplement; and
- an average LPI premium of $1,500.00

Impact of Free or Below-Cost Tracking Services on LPI Costs to Force-Placed Borrowers

	Subsidized Tracking Impact on LPI Charges	Scenario 1	Scenario 2
1	Loans Tracked	1,000,000	1,000,000
2	Tracking Fee Charged per loan per month	$0.10	$0.10
3	True Cost of Tracking Services per loan per month	$0.90	$0.50
4	Subsidy/Kickback	$0.80	$0.40
5	Total Annual Kickback (line 1 x line 4 x 12 months)	$9,600,000	$4,800,000
6	Placement Rate -- 1.56% is Assurant's actual 20Q2 rate	1.56%	1.56%
7	Average LPI Premium	$1,500	$1,500
8	Total LPI Premium (line 1 x line 6 x line 7)	$23,400,000	$23,400,000
9	**Tracking Kickback as % of Premium** **(line 5 / line 8)**	41%	21%
10	**Tracking Cost borne by each LPI-placed borrower**	$615	$308

The calculations show that a subsidy of "just" 40 cents per loan per month represents from 21% to 41% or $308 to $608 of a $1,500 premium. Stated differently, these kickbacks unfairly inflate the charges to borrowers by 26% to 70%.

Insurers and Trades Have Provide No Evidence to Support Their Claims or To Justify Insurance Tracking as a Legitimate LPI Expense.

Industry has made the two principle arguments regarding tracking expenses without providing any evidence to support their arguments. First, they argue that tracking is an insurer, not a servicer responsibility, and that servicers are not compensated for insurance tracking activities. CEJ has provided extensive evidence to authoritatively refute these insurer claims. It is simply not feasible to objectively review the respective evidence provided by CEJ and industry and not dismiss these industry claims.

The second industry argument is that tracking is necessary for the insurers' risk and exposure management and, consequently, tracking expenses are reasonably included in LPI rates. Again, CEJ has provided evidence to refute these assertions.

First, the largest LPI insurer, Assurant, admits that the provision of LPI and insurance tracking are separate. On its website, Assurant describes "Lender-Placed Insurance & Related Services:[8]

[8] https://www.assurant.com/partner-with-us/lender-placed-insurance

> Assurant is the industry's leading provider of lender-placed hazard, flood, wind and REO insurance, and related services. Our core services provide insurance tracking and follow-up on behalf of our partners to ensure customers have current homeowners insurance. We offer inbound and outbound customer support, including easy self-service options. And, when necessary, we protect mortgage servicers interest with our lender-placed insurance products.

Second, the "exposure management" argument is a blatant misrepresentation to regulators. Insurers do not need individual tracking data – nor could they rely upon such data – to manage their exposure. Unlike voluntary insurance where today' insureds are a good proxy for the exposures in three or six months, that is not the case with LPI. With LPI, the cancellation rate is high – 50% or more – which means that today's exposures are going to be different from the insureds in six months.

LPI insurers underwrite, price and manage LPI exposures by evaluating characteristics of the loan portfolio – location of loans, size of loans, types of lenders, presence of escrow or not. It is by assessing characteristics of the loan portfolio that LPI insurers can estimate the placement rate of LPI. The evidence to support this is found in the schedule rating worksheets of LPI insurers, shown in the FL OIR presentation.

In the case of the Assurant Schedule Rating Plan, Assurant states, "in recognition of the unique risk characteristics of the mortgagee." The mortgagee is the lender/servicer and not the borrower. The Schedule Rating Plan factors are all related to characteristics of the loan portfolio – quality of loan underwriting, source of loans, delinquency rate, average loan to value, mix of fixed and variable loans, mix of government and conventional loans, percentage of loans escrowed for insurance – and nothing related to individual borrower's property characteristics or rating.

Again, common sense refutes this industry argument. If inclusion of insurance tracking expenses were necessary for exposure management, then it could not be possible for Assurant or any LPI insurer to offer LPI in New York or Rhode Island where tracking expenses must be excluded from LPI rates. Yet, Assurant and LPI insurer do offer LPI in New York and Rhode Island, demonstrating that inclusion of tracking expenses is in LPI rates for LPI insurers to manage their risk or exposure.

In addition, if insurance tracking and individual loan insurance information was required for exposure management, how could a LPI insurer ever be able to write new business or secure reinsurance since, in those situations, it would either not have individual loan insurance information or the information would rapidly change over a short period of time. But, in fact, LPI insurers do compete for and secure new business and do obtain reinsurance. This is possible because risk and exposure management are based on characteristics of the loan servicing portfolio and general economic conditions.

Prohibiting Tracking Expenses in LPI Rates Does Not Limit Regulators' Ability to Evaluate LPI Insurer Expenses

An argument has been put forth that including a provision in the model to prohibit the inclusion of insurance tracking expenses in LPI rates will somehow restrict a regulator's ability to assess the reasonableness of expense provisions proposed by LPI insurers in rate filing. Again, no evidence has been provided to support this claim.

It is unclear how prohibiting one type of expense limits a regulator's ability to examine proposed expense provisions in a LPI rate filing and no explanation or examples have been provided.

In fact, the exposure draft prohibits and permits a variety of different types of expenses. The draft prohibits certain compensation to a lender, insurer, investor or servicer. The draft prohibits contingent commission and profit-sharing to any person affiliated with the servicer or the insurer. The draft prohibits the provision of free-or below-cost outsourced services. The draft permits implementation expenses.

All of these provisions assume the regulator has the ability to identify different types of LPI insurer expenses and permit or exclude those expenses in approved LPI rates. Consequently, there is no basis for the claim that a regulator could not identify one type of expenses – insurance tracking – and require the insurer to exclude that expense from approved rates.

The Omission of Any Disclosure Requirements in the Exposure Draft Confirms That Insurance Tracking is a Servicer Responsibility

Unlike the current Creditor-Placed Insurance Model Act which includes a section for "Disclosures to the Debtor," the LPI Model Act exposure draft includes no disclosure provisions. Clearly, consumer disclosures – such as those in Regulation Z, cited above – regarding missing evidence of required insurance and possible LPI placement and charges are part of insurance tracking. If insurance tracking was, in fact, an insurer responsibility, then it would be the insurer, not the servicer, who is responsible for providing these consumer disclosures. The fact that industry has argued against including disclosure provisions in the NAIC model contradicts the argument that tracking is an insurer responsibility and expense.

III. Prohibit Single Interest Coverage

The model fails to require that LPI policies provide dual interest coverage. While dual interest coverage is most common, there remain instances of single interest LPI home insurance. Such single interest coverage eliminates any borrower rights in the event of a LPI claim.

It is critical for LPI to provide dual interest coverage – in which the borrower is an additional insured on the coverage – to give the borrower important rights in the event of a LPI claim. It is important because the interests of the borrower and servicer do not align. The servicer may only have interest in obtaining a claim settlement sufficient to pay off the loan, while the borrower has an interest in repairing the property.

Requiring dual interest coverage is a basic consumer protection and should not be controversial.

IV. Loss Ratio Standard

The proposed loss ratio standard of 35% is far, far too low and fails to reflect the cost structure of LPI. The table below highlights some of the key differences affecting sales, underwriting and administrative expenses for LPI versus homeowners insurance. LPI is a group master policy issues to a servicer covering all properties automatically as needed if a borrower's voluntary coverage lapses. A single LPI policy may provide coverage for hundreds of thousands of loans and thousands of individual property coverages.

LPI	Homeowners
Group Policy Covering All Loans in Servicer's Portfolio Regardless of Location or Condition	Individual Policy Per Property
No Individual Property Underwriting	Individual Property Underwriting
No Individual Borrower Underwriting	Individual Policyholder Underwriting
Automatic Coverage At Moment of Lapse, Whether or Not Servicer is Aware of Lapse at That Time	Insurer May Decline Coverage
Automated Coverage Issuance Based on Servicer's Tracking Data and Instructions	Coverage Issued Specifically for Underwritten Policyholder and Property
Servicer is Named Insured, Servicer Pays Premium to Insurer	Consumer is Named Insured, Consumer Pays Premium to Insurer

Every non-claim aspect and expense category is less expensive as a percentage of premium than for homeowners insurance. There is no mass marketing of LPI. LPI is marketed to tens or hundreds of lenders/servicers, not to tens of millions of consumers. There is no detailed underwriting or complex pricing algorithms for LPI as there is for homeowners insurance because of the lack of underwriting of individual properties for LPI. Rather, LPI is underwritten on the basis of loan servicing portfolio characteristics.

Given the characteristics of LPI, non-claim expenses for LPI should be significantly less as a percentage of premium than non-claim expenses for homeowners – and LPI loss ratios should be higher than homeowners loss ratios. Yet, the opposite has occurred and continues to occur – LPI loss ratios are half those of homeowners insurance and LPI expense ratios are two or more times greater than those of homeowners.

Because of reverse competition in LPI markets, LPI insurers seek the high rates to compete for the servicer's business by providing considerations to the servicer to secure that business. An insurance regulator can minimize the harm of this reverse competition by approving only those rates sufficient to cover expected loss and loss settlement costs, a reasonable profit and the reasonable expenses for sale and administration of LPI. The characteristics of LPI – the long history of kickbacks by LPI insurers to servicers – clearly indicate that LPI loss ratios should be higher and not lower than those for homeowners insurance.

The proposed 35% is absurdly low on its face and no support or explanation has been provided for that value. Such a low minimum standard would lead to even higher LPI rates because typical LPI rate filings propose expected loss ratios greater than 35% -- even with inflated expenses.

Given that varying catastrophe risk exposure across the states, this minimum loss ratio provision should be deleted and replaced with a maximum expense provision. Failing that, a minimum 60% loss ratio provision should be used, consistent with other NAIC credit-related insurance model loss ratio standards. Failing that, the minimum loss ratio standard provision should be removed and rate review should default to a standard prior approval review to ensure rates are not excessive, not inadequate and not unfairly discriminatory.

V. Implementation Expense

The provision to permit "implementation expenses" should be deleted for a number of reasons. First, the implementation expense issue is being addressed at the Innovation and Technology Task Force through its work to review the anti-rebating provisions in the NAIC Unfair Trade Practices Act. True "implementation expense" issues should be addressed in that forum.

Second, the proposed provision undercuts the general anti-kickback provision by permitting the insurer to provide a consideration to the lender/servicer in exchange for the lender/servicer selecting the LPI vendor. We are puzzled by this provision since paying a lender/servicer for "implementation expense" is clearly a consideration and a kickback as the LPI vendor is rebating something of value to the insured in exchange for securing the business.

Third, in addition to being a glaring kickback, this provision promotes unfair competition because the largest LPI vendor has the greatest ability to provide the greatest "implementation expense reimbursement."

Fourth, the fact that Assurant was able to convince a number of regulators to include this gaping kickback loophole in the regulatory settlement agreement is powerful evidence of the need for an absolute ban on any consideration by the insurer to the servicer other than the protection of the property servicing as collateral for the loan. Permitting things like "implementation expenses" if they can be satisfactorily explained will lead to consumer abuse and unreasonable rates and charges -- the insurer will always explain or shade the explanation in an effort to make any expense seem in compliance with statutory requirements and they are in the cat bird seat of information asymmetry -- they know all the details and how to frame things to get by the regulator, while the regulators, particularly in states where the insurance regulator is separate from the banking regulator, have limited knowledge of mortgage servicing and limited time and resources to do forensic accounting for each rate filing.

Fifth, an exception for "implementation expenses" – or tracking expenses – will lead to a lack of uniformity across the states, based in large part on the size and resources of the state to understand and review justifications provided by the LPI insurer. While there are many reasons for rate filing considerations to vary by state – catastrophe exposure, underwriting restrictions – differences in what constitutes a reasonable general, administrative or sales expense for insurance typically sold through countrywide agreements is surely not an expense that should vary by state.

VI. Reverse Competition

LPI markets are characterized by reverse competition, which means that the insurers compete for the lender's or servicer's business because these entities have the market power to steer the ultimate consumer to the insurer. In a reverse-competitive market, the insurers compete for the lender's or servicer's business by offering a variety of considerations to the lender, the cost of which drives up the cost of the insurance to the ultimate consumer.

Evidence from regulatory and journalist investigations, class action lawsuits and regulatory settlements indicates that the LPI premium charges from LPI insurers to mortgage servicers are inflated far above the reasonable cost of providing LPI coverage to protect the properties serving as collateral for the mortgage loans. A significant amount of the inflated LPI premiums charged by the LPI insurer to the mortgage servicer is kicked back to the mortgage servicer through a variety of mechanisms, including the provision of free or below-cost services. The mortgage servicer typically charges borrowers the same amount for LPI as the mortgage servicer paid in premium to the LPI insurer, thereby causing borrowers to pay for the kickbacks.

The NAIC recognized reverse competition in credit-related insurance markets. The Credit Personal Property Insurance Model Act includes, as one of its purposes, to "address the problems arising from reverse competition in credit insurance markets." LPI is a credit –related insurance product. The NAIC model also defines and explains reverse competition:[9]

> "Reverse competition" means competition among insurers that regularly takes the form of insurers vying with other for the favor of persons who control, or may control, the placement of the insurance with insurers. Reverse competition tends to increase premiums or prevent the lowering of premiums in order that greater compensation may be paid to persons for such business as a means of obtaining the placement of business. In these situations, the competitive pressure to obtain business by paying higher compensation to the persons overwhelms any downward pressure consumers may exert on the price of insurance, thus causing prices to rise and remain higher than they would otherwise."

From 2011 to 2013, the New York State Department of Financial Services conducted an investigation of LPI providers and markets. Among other things, the NYDFS investigation revealed:

- The premiums charged to homeowners for force-placed insurance are two to ten times higher than premiums for voluntary insurance, even though the scope of the coverage is more limited.
- The loss ratios for force-placed insurance seldom exceed 25 percent. Nevertheless, rate filings made by insurers with NYDFS reflected loss ratio estimates of 55 to 58 percent.
- Insurers and banks have built a network of relationships and financial arrangements that have driven premium rates to inappropriately high levels ultimately paid for by consumers and investors.

[9] https://content.naic.org/sites/default/files/inline-files/MDL-365.pdf

- Force-placed insurers have competed for business from banks and mortgage servicers through "reverse competition": i.e., rather than competing for business by offering lower prices, insurers have created incentives for banks and mortgage servicers to buy force-placed insurance with high premiums by enabling banks and mortgage services, through complex arrangements, to share in the profits associated with the higher prices.

In addition to regulatory settlements with LPI insurers to stop the consumer abuses, the NY DFS has promulgated a regulation which, among other consumer protections, prohibits the inclusion of insurance tracking expenses in LPI rates.

Based on the above, it is important and reasonable to include in the LPI model a purpose to address problems arising from reverse competition, the definition of reverse competition and provisions which, in fact, protect consumers from reverse competition.

CENTER for ECONOMIC JUSTICE | FAIR ACCESS FAIR TREATMENT

Key Issues in Development of NAIC Lender-Placed Insurance Model Law

Discussion with Florida Office of Insurance Regulation

October 31, 2018

Birny Birnbaum
Center for Economic Justice

The Center for Economic Justice

CEJ is a non-profit consumer advocacy organization dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. Most of our work is before administrative agencies on insurance, financial services and utility issues.

On the Web: www.cej-online.org

About Birny Birnbaum

Birny Birnbaum is the Director of the Center for Economic Justice, a non-profit organization whose mission is to advocate on behalf of low-income consumers on issues of availability, affordability, accessibility of basic goods and services, such as utilities, credit and insurance.

Birny, an economist and former insurance regulator, has authored reports and testimony for numerous public agencies and consumer organizations, covering a wide variety of topics, including analysis of insurance markets, insurers' use of big data, market regulation, force-placed insurance, homeowners and flood insurance, consumer credit insurance, title insurance and insurance credit scoring. He has served for many years as a designated Consumer Representative at the National Association of Insurance Commissioners. He is a member of the Federal Advisory Committee on Insurance, chairing the Subcommittee on Affordability and Availability of Insurance.

Birny served as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. In that role, Birny was responsible for review and approval of rate filings, the development of data collection programs for market surveillance and the analysis of competition in numerous insurance markets.

Prior to his work at the TDI, Birny served as Chief Economist at the Texas Office of Public Insurance Counsel where he provided expert testimony in rate and rule hearings on behalf of insurance consumers before the TDI. While at OPIC, Birny performed the first auto insurance redlining study in Texas.

Birny was educated at Bowdoin College and the Massachusetts Institute of Technology. He holds the AMCM certification.

Summary

Contrast CEJ and Industry arguments on the basis of **facts and evidence.**

1. Tracking Expenses Are Not Insurance Expenses and Must Be Excluded from LPI Rates and LPI Charges to Borrowers.

2. All Kickbacks Must Be Prohibited to Stop the Kickback Mentality of LPI Insurers and Lenders/Servicers. So-Called "Implementation Expenses" Are Just Another Kickback and Must Not Be Permitted.

3. Unfair to Consumers to Rely on Regulatory Settlement As Justification for Anti-Consumer Model Law Provisions.

4. The Model Must Include Disclosure Requirements and Such Requirement Should Track Those of the CFPB Mortgage Servicing Rule.

5. A Servicer's LPI Charge to a Borrower is Not an Insurance Premium.

Key Features of LPI Vs. Homeowners Insurance

LPI is a Group Master Policy Issued to Servicer Covering All Properties Automatically As Needed If Borrower's Voluntary Coverage Lapses.

LPI	Homeowners
Group Policy Covering All Loans in Servicer's Portfolio Regardless of Location or Condition	Individual Policy Per Property
No Individual Property Underwriting	Individual Property Underwriting
No Individual Borrower Underwriting	Individual Policyholder Underwriting
Automatic Coverage At Moment of Lapse, Whether or Not Servicer is Aware of Lapse at That Time	Insurer May Decline Coverage
Automated Coverage Issuance Based on Servicer's Tracking Data and Instructions	Coverage Issued Specifically for Underwritten Policyholder and Property
Servicer is Named Insured, Servicer Pays Premium to Insurer	Consumer is Named Insured, Consumer Pays Premium to Insurer

1. Tracking Expenses Are Not Insurance Expenses and Must Be Excluded from LPI Rates and LPI Charges to Borrowers.

a. Insurance is Required by the Lender and Mortgage Contract, Not the Insurance Policy. Tracking of Insurance Follows From the Mortgage Contract Requirement.

Fannie Mae Standard Contract: Property Insurance. Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term “extended coverage,” and any other hazards including, but not limited to, earthquakes and floods, ***for which Lender requires insurance.*** This insurance shall be maintained in the amounts (including deductible levels) and for the periods ***that Lender requires.*** What Lender requires pursuant to the preceding sentences can change during the term of the Loan. The insurance carrier providing the insurance shall be chosen by Borrower subject to Lender’s right to disapprove Borrower’s choice, which right shall not be exercised unreasonably.

If Borrower fails to maintain any of the coverages described above, Lender may obtain insurance coverage, at Lender’s option and Borrower’s expense. Lender is under no obligation to purchase any particular type or amount of coverage. Therefore, such coverage shall cover Lender, but might or might not protect Borrower, Borrower’s equity in the Property, or the contents of the Property, against any risk, hazard or liability and might provide greater or lesser coverage than was previously in effect. Borrower acknowledges that the cost of the insurance coverage so obtained might significantly exceed the cost of insurance that Borrower could have obtained. ***Any amounts disbursed by Lender under this Section 5 shall become additional debt of Borrower secured by this Security Instrument.*** These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

b. Tracking is a Responsibility of the Lender/Servicer

i. Fannie/Freddie Servicing Guidelines

Fannie Mae Servicing Guidelines, Section B

The ***servicer*** must ensure at all times that any required property insurance coverage is maintained to protect Fannie Mae's interest in the mortgage loan.

The servicer must

- Verify annually that the selected insurance carrier, policy amount and type of coverage meet Fannie Mae's requirements
- Ensure property premiums are paid
- Immediately obtain new coverage to meet Fannie Mae's requirement if the borrower allows the insurance coverage to lapse. See B-6-01, Lender-Place Insurance Requirements for additional information.

Fannie Mae Servicer Responsibilities Related to Lender-Placed Insurance

If the servicer cannot obtain evidence of acceptable property or flood insurance for a property securing a mortgage loan, the servicer must obtain lender-placed insurance in compliance with Fannie Mae's insurance requirements.

The servicer must

- Only issue lender-placed insurance coverage after it makes unsuccessful attempts to obtain evidence of insurance in accordance with applicable law.
- Not use a lender-placed insurance carrier that is an affiliated entity, as defined below, for a lender-placed insurance policy, including any captive insurance or reinsurance arrangements with an affiliated entity.
- Exclude any lender-placed insurance commissions or payments (including any incentive based compensation regardless of its designation as commission, bonus, fees, or other types of payments from the servicer's lender-placed insurance carrier; for example, underwriting bonuses or other payments based on insurance loss ratios) earned on a lender-placed insurance policy by the servicer, broker, or any affiliated entity, as defined below, from the lender-placed insurance premiums charged to the borrower or submitted for reimbursement from Fannie Mae.
- In compliance with applicable law, terminate any lender-placed insurance, and refund all lender-placed insurance premiums and fees charged during any period of coverage overlap.

ii. **Flood Disaster Protection Act, 42 USC 4012(b)1**.

Each Federal entity for lending regulation . . . . shall by regulation ***direct regulated lending institutions***—

(A) not to make, increase, extend, or renew any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified by the Administrator as an area having special flood hazards and in which flood insurance has been made available under the National Flood Insurance Act of 1968 . . . unless the building or mobile home and any personal property securing such loan is covered for the term of the loan by flood insurance in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular type of property, whichever is less;

iii. Regulation Z (12 CFR 1024) Mortgage Servicing Requirements

Section 1037:

(b) Basis for charging borrower for force-placed insurance. A ***servicer*** may not assess on a borrower a premium charge or fee related to force-placed insurance unless the servicer has a reasonable basis to believe that the borrower has failed to comply with the mortgage loan contract's requirement to maintain hazard insurance.

(c) Requirements before charging borrower for force-placed insurance -

(1) In general. ***Before a servicer assesses on a borrower*** any premium charge or fee related to force-placed insurance, ***the servicer must:***

(i) Deliver to a borrower or place in the mail a written notice containing the information required by paragraph (c)(2) of this section at least 45 days before a servicer assesses on a borrower such charge or fee;

(ii) Deliver to the borrower or place in the mail a written notice in accordance with paragraph (d)(1) of this section; and

(iii) By the end of the 15-day period beginning on the date the written notice described in paragraph (c)(1)(ii) of this section was delivered to the borrower or placed in the mail, not have received, from the borrower or otherwise, evidence demonstrating that the borrower has had in place, continuously, hazard insurance coverage that complies with the loan contract's requirements to maintain hazard insurance.

(d)Reminder notice -

(1) In general. The notice required by paragraph (c)(1)(ii) of this section shall be delivered to the borrower or placed in the mail at least 15 days before a servicer assesses on a borrower a premium charge or fee related to force-placed insurance. ***A servicer may not deliver*** to a borrower or place in the mail the notice required by paragraph (c)(1)(ii) of this section until at least 30 days after delivering to the borrower or placing in the mail the written notice required by paragraph (c)(1)(i) of this section.

(e)Renewing or replacing force-placed insurance -

(1)In general. Before ***a servicer assesses on a borrower*** a premium charge or fee related to renewing or replacing existing force-placed insurance, a servicer must:

(i) Deliver to the borrower or place in the mail a written notice containing the information set forth in paragraph (e)(2) of this section at least 45 days before assessing on a borrower such charge or fee; and

(ii) By the end of the 45-day period beginning on the date the written notice required by paragraph (e)(1)(i) of this section was delivered to the borrower or placed in the mail, not have received, from the borrower or otherwise, evidence demonstrating that the borrower has purchased hazard insurance coverage that complies with the loan contract's requirements to maintain hazard insurance.

(iii)Charging a borrower before end of notice period. Notwithstanding paragraphs (e)(1)(i) and (ii) of this section, if not prohibited by State or other applicable law, if a servicer has renewed or replaced existing force-placed insurance and receives evidence demonstrating that the borrower lacked insurance coverage for some period of time following the expiration of the existing force-placed insurance (including during the notice period prescribed by paragraph (e)(1) of this section), the servicer may, promptly upon receiving such evidence, assess on the borrower a premium charge or fee related to renewing or replacing existing force-placed insurance for that period of time.

(g)Cancellation of force-placed insurance. Within 15 days of receiving, from the borrower or otherwise, evidence demonstrating that the borrower has had in place hazard insurance coverage that complies with the loan contract's requirements to maintain hazard insurance, ***a servicer must:***

(1) Cancel the force-placed insurance the servicer purchased to insure the borrower's property; and

(2) Refund to such borrower all force-placed insurance premium charges and related fees paid by such borrower for any period of overlapping insurance coverage and remove from the borrower's account all force-placed insurance charges and related fees for such period that the servicer has assessed to the borrower.

(h)Limitations on force-placed insurance charges -

(1)In general. Except for charges subject to State regulation as the business of insurance and charges authorized by the Flood Disaster Protection Act of 1973, all charges related to force-placed insurance assessed to a borrower by or through the servicer must be bona fide and reasonable.

(2)Bona fide and reasonable charge. A bona fide and reasonable charge is a charge for a service actually performed that bears a reasonable relationship to the servicer's cost of providing the service, and is not otherwise prohibited by applicable law.

Summary: The Servicer is responsible for ensuring required insurance is in place and is responsible for any tracking associated with this requirement.

c. The Lender/Servicer is Paid by Mortgage Owners to Perform Tracking

Servicers are paid a fee by mortgage owners/investors to service the mortgage loan. Thomas Pinkowish, author of the text *Resident Mortgage Lending*, 6th Edition, writes that for a loan servicer to fulfill these responsibilities, the servicer will typically have separate departments to perform five essential functions:

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:

> "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.
>
> 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 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."

d. Including Tracking in LPI Rates and LPI Charges to Borrowers Causes Lenders/Servicers to Be Paid Twice for Tracking

Since mortgage owners/investors pay a fee to servicers that covers, among other things, insurance tracking, including insurance tracking in LPI rates and LPI charges to borrowers pays the servicer twice for the same activity.

In addition, including tracking in LPI rates and LPI charges to borrowers means that only those borrowers charged for LPI pay for the insurance tracking expenses in LPI rates – with the outcome that, say, 2% of borrowers pay for an expense properly associated with the entire portfolio of borrowers.

Even if no borrower failed to maintain required insurance, the servicer would still be required to perform insurance tracking to cove the possibility of such a lapse.

e. Tracking is Not Used for Risk or Exposure Management

i. Schedule Rating Shows Underwriting Based on Aggregate Loan Portfolio Characteristics, Not Individual Loan Tracking Info

G. SCHEDULE RATING PLAN

In recognition of the unique risk characteristics of each mortgagee, the rates may be modified in accordance with the following schedule to reflect characteristics of the risk not contemplated in the base rates.

The maximum rate modification is (+) or (-) 25%.

1) Criteria	Range of Modification		
	Debit		Credit
a) Quality of Loan Underwriting	+ 20%	to	- 20%
(1) Quality of Underwriting			
(2) Source of Real Estate Loans – Direct and Indirect			
(3) Overall Delinquency Ratio			
(4) Average Loan to Value			
b) Quality of Loan Portfolio	+15%	to	-15%
(1) Mix - Government and Conventional			
(2) Mix – Fixed and Variable			
(3) Escrowed for Payment of Insurance			
c) Transactional Efficiency Systems Compatibility, Data Quality/Accuracy, Automation, Reconciliation Capabilities, Service Standards	+ 10%	to	- 10%
d) Management Experience	+10%	to	-10%

2) The credits or debits shall be summed and, if applicable, capped by the maximum modification to determine the schedule rate modification.
3) All schedule credits and all schedule debits shall be based on evidence that is contained in the file at the time the schedule credit or debit is applied.
4) The effective date of any schedule credit or debit shall not be any date prior to our receipt of the evidence supporting the credit or debit.
5) Any modification developed under this plan shall be for the term of the policy, subject to company review. If the modification proves to be inequitable because of materially changed conditions, a new modification based upon such changed conditions shall be established. The new modification will apply to all new and renewal certificates effective on or after the date of such change.
6) To be eligible, a minimum policy premium of $1,000 applies.

Lender Name:		**Year:**	
Agent Number:		**State:**	FL
Lender Number:		**Product:**	Hazard Insurance Protection LP
Policy Eff. Date:			

Praetorian Insurance Company

Hazard Insurance Protection

Account Rate Modification Plan

The following debits and credits will be applied to the appropriate base rates to recognize special characteristics of the risk not contemplated in our base rates. The maximum modification allowed is + / - 25%. Documentation supporting qualification for scheduled rating will be maintained by this the policy term, new debits/credits will be calculated and applied on future coverage requests.

Risk Characteristics	**Range of Modification**		**Lender Rating**
	Credit	Debit	
30+ day contractual delinquency rate measured as a % of total active mortgage loans.	-15%	+15%	0.00%
Foreclosure loans measured as a % of total active mortgage loans.	-10%	+10%	0.00%
Named Insured choice to purchase coverage for the lesser of value of improvements or unpaid principal balance.	-10%	+10%	0.00%
Operating Expenses Associated with Lender Placed Program	-15%	+15%	0.00%
Loss History for Hazard Insurance Protection	-15%	+15%	0.00%
Concentration of exposures in high risk (catastrophe prone) areas.	-15%	+15%	0.00%
Average property values.	-15%	+15%	0.00%
	TOTAL		0.00%
Maximum Debit or Credit to be applied is 25% Qualifier - Minimum Size of Account Must Equal $500,000 Annual W.P. or 50,000 loans			

CALIFORNIA
AMERICAN MODERN HOME INSURANCE COMPANY
Mortgage Security Program

Rate Deviations Factors (maximum 25%)

	Factors	Decrease	Increase
1. Loan Portfolio Size	1%	Over 20,000	Under 5,000
2. Loan Origination Type	5%	100% Direct	50% Indirect
3. Geographical Concentration	15%	90% Low Risk Area	50%+ High Risk Area
4. #Foreclosed/REO Properties	5%	1% or less	25% or more
5. #Foreclosed Commercial Properties	5%	1% or less	25% or more
6. Delinquency Ratios	5%	50% Under National Average	50% Above National Average
7. Combined Ratio History	5%	Below 95.0%	
8. Combined Ratio History	10%		Between 95.1% - 97.5%
9. Combined Ratio History	15%		Between 97.6% - 100.0%
10. Combined Ratio History	20%		Above 100.0%
11. General Management Capability	1%	Average of #'s 3+4+5+6 above	Average of #'s 3+4+5+6 above

ii. UW based on Aggregate Loan Portfolio Characteristics Makes Sense / UW based on Individual Loan Tracking Does Not

1. If Tracking was required for exposure management / underwriting, no company would be able to write new business or secure reinsurance because it would not have individual policy data. Fact is that LPI insurers do secure new business and do obtain reinsurance, despite the fact that the number and location of LPI-insured properties can and does change quickly over time. How is this possible? Risk and exposure management based on loan portfolio characteristics – LPI insurers know what loan portfolio characteristics – and general economic conditions – are associated with higher or lower placement rates in what locations.

2. With no individual property underwriting and take all comers, LPI portfolio today is no guaranty – or necessarily even a good indication of – LPI portfolio in six months as LPI coverages come on and off the books for a variety of factors. Unlike traditional homeowners with the ability to underwrite and a reasonable expectation that today's exposures will be very similar to those in nine months, same argument cannot be made for LPI with no underwriting of individual properties

iii. Existence of Blanket LPI – LPI Coverage Based on Total Exposure (e.g., total outstanding principal balance) with no tracking and individual charges to borrowers – demonstrates tracking ***not*** required for sale and administration of LPI.

f. If Blanket Coverage is Available, Why is Tracking Done?

- To enable mortgage owners to reimburse servicers for LPI charges unpaid by borrowers (and, consequently, the requirements by Fannie/Freddie/Mortgage-Backed Security Investors for insurance tracking by servicers.)

- To charge for LPI only those borrowers who have lapsed coverage.

g. Tracking Not a "Marketing" Expense

Communication with Borrowers, Voluntary Insurersand Agents Regarding Required Insurance is Lender/Servicer Responsibility.

h. Distinction Between Who ***Performs*** Tracking and Who is ***Responsible*** for Tracking; Between Who ***Performs*** Tracking and Who ***Pays or Should Pay*** for Tracking;

i. Fact That Servicer Outsources Tracking to Vendor Providing LPI Does Not Make Tracking a LPI Expense.

ii. Fact That Servicer Outsources Tracking Does Not Change Fact That Mortgage Owner/Investor Has Paid Servicer to Track Loans for Insurance to Protect the Owner/Investor's Interest.

2. All Kickbacks Must Be Prohibited to Stop the Kickbacks by LPI Insurers to Lenders/Servicers. So-called "Implementation Expenses" Are Just Another Kickback and Must Not Be Permitted.

a. LPI Market is Glaring Example of Reverse Competition – Competition for Business Based on Kickbacks – "Commissions," "Expense Reimbursement," Captive Reinsurance, Affiliated Business Arrangements, Free and Below-Cost Services

b. LPI Insurers' Business Model – Use Kickbacks to Secure Business Even If Such Kickbacks Are Prohibited – Getting Caught is Infrequent and Cost of Doing Business.

i. In lieu of "commissions" to servicer-affiliated agencies, LPI insurer buys the agency for an amount equal to prepaid commissions

ii. Original NY and FL settlements – "exception" became massive loophole (since closed by NY DFS) – did not result in lower LPI rates or lower LPI charges to borrowers

ASIC shall not provide free or below-cost outsourced services to Servicers or their affiliates, provided, however, that outsourced services do not include expenses associated with ***tracking functions that ASIC incurs for its own benefit to identify and protect itself from (a) exposure to lost premium and losses on properties on which no other insurance coverage is in effect or (b) administrative costs associated with providing and subsequently canceling LPI on properties on which LPI is not required;***

c. Current Proposed Loophole Expansive, Impossible to Enforce and License for Kickbacks

The prohibitions and requirements set forth in this paragraph shall not preclude an insurer or insurance producer from ***reimbursing implementation expenses incurred by a lender/servicer. Implementation expenses that are reimbursed shall be supported by documentary or other physical or electronic evidence (including but not limited to invoices and work orders) of their expenditure by the lender/ servicer.*** Such expenses must bear a direct relationship to the implementation of the insurer's or insurance producer's lender-placed insurance program at program inception.

i. No rationale for permitting implementation expenses – makes no more sense here than it would to permit State Farm to reimburse some consumers for "implementing" his or her auto or homeowners policy.

ii. Insurance regulators have no more knowledge of “implementation expenses” than they have had of any of the other inappropriate expenses because mortgage servicing is not an area of insurance regulator expertise. Insurers and servicers have employed regulatory arbitrage – insurance regulators’ lack of knowledge about loan servicing – to exploit loopholes like “implementation expenses” and “tracking for own benefit” to continue the kickback structure of LPI markets.

iii. Practically, impossible to implement this regulatory requirement – insurer can call a kickback an implementation expense and, absent forensic accounting, impossible to detect.

iv. Absolute, total prohibition against any considerations by LPI insurer to servicer –other than the protection of the collateral pledged for the loan – essential for addressing reverse competition and stopping kickbacks paid for by borrowers.

3. Unfair to Consumers to Rely on Regulatory Settlement As Justification for Model Law Provisions.

a. Settlement – negotiation – to avoid litigation.

b. Negotiation between two parties with no public input.

c. Not a rulemaking process with opportunity for interested parties to inform the discussion.

d. Insurance regulators' history of permitting loopholes with unintended consequences.

e. Continues to permit and authorize kickbacks

4. **The Model Must Include Disclosure Requirements and Requirement Should Track Those of the CFPB Mortgage Servicing Rule.**

5. **Litigation and Filed-Rate Doctrine Defense**

Discussion of Proposed NAIC Lender Placed Insurance Model Act with Florida Office of Insurance Regulation

Center for Economic Justice Responses to Florida OIR Questions Following October 31, 2018 Conference Call with Interested Parties.

Submitted November 26, 2018

OIR Questions in Italics

The focus of our conversation on October 31, 2018, centered around whether tracking or implementation expenses should be included in rates for Lender Placed Insurance. The regulatory settlement agreements executed by LPI insurers did not preclude tracking expenses in LPI rates on the theory that reasonable expenses should and could be included. However, questions have been raised about exactly how those expenses are incurred and by whom, who pays for and is paid for such services and whether those expenses should be paid out of the LPI premium or the loan transaction. To help answer these questions, and to prepare for the follow up call on November 28, 2018 it would be helpful for both parties to provide written answers to the questions below. Please refer to the discussion document provided for the October 31, 2018 call.

CEJ Response: It is unclear why the regulatory settlement agreements did or did not include anything because the discussions were not public nor open to public comment. The reason that tracking expenses – as explicitly defined in the CEJ proposal to the NAIC LPI working group – must be excluded from LPI rates – and, consequently, LPI charges to borrowers – is because these expenses are not associated with the provision of LPI and, consequently, are unreasonable to include in LPI rates. Tracking expenses are as unreasonable to include in LPI rates as:

- expenses associated with disbursing funds from borrowers' escrow accounts for hazard insurance ("escrow administration"), or
- expenses associated with monitoring claim-related repairs on voluntary insurance policies ("loss drafts"), or
- expenses associated with loading information from the loan application into the servicing system of record databased ("onboarding").

Activities not related to the actual provision of LPI are unreasonable to include in LPI rates and, consequently, in LPI charges to borrowers. The table below identifies various activities associated with tracking voluntary insurance and placing LPI and whether those activities are the responsibility of the servicer (who may outsource the activity) or of the insurer. It is only those activities identified as the responsibility of the insurer that are reasonable expenses to include in LPI rates.

Servicing and Insurance Activities Related to LPI

Activity	Servicing vs. Insurance
Tracking Insurance	
Flood Zone Determination	Servicing
Loading Insurance Information into Database	Servicing
Maintaining/Monitoring Insurance Tracking Database	Servicing
Contacting Borrowers, Problems with Insurance	Servicing
Customer Service Borrowers Insurance Evidence	Servicing
Contacting Insurers/Agents Insurance Evidence	Servicing
Placing Insurance	
Notifying Insurer to Issue Binder or Policy	Servicing
Issuing Temporary Binder	**Insurance**
Determining Coverage Amount	Servicing
Servicer Payment to Insurer	**Insurance**
Billing Borrower for LPI Premium	Servicing
Setting up Escrow when necessary for LPI	Servicing
Refunds to Servicer	**Insurance**
Refunds to Borrower	Servicing
Issuing Permanent Policy	**Insurance**
Customer Service about Insurance Placement	Servicing
Customer Service about Borrower Refunds	Servicing
Customer Service about LPI Claims	**Insurance**

The kickback mechanism can be illustrated as follows. Let's assume that the true cost of providing LPI coverage through a group policy in which individual coverages are issued at the direction of the servicer is $X. But, the LPI insurer charges a premium amount to the servicer of $2X. The servicer then assesses a charge to the borrower styled as LPI of $2X. But the true cost of the LPI to servicer is not $2X, but $X because the LPI vendor provides considerations worth another $X to the servicer. This was historically done through "commissions," "expense reimbursements," "captive reinsurance" and below-cost or free services unrelated to the provision of LPI. Since most of these standard kickback mechanisms have been prohibited, the go-to kickback mechanism is free or below-cost services. That is why the language in the NY and FL settlements allowing "tracking for the insurers' purpose" was revised by NY – it was exploited by the LPI vendors to include all types of tracking expenses in LPI rates.

1. *Slide 5 of the attached presentation asserts that any amounts disbursed by the Lender for LPI premium shall become additional debt of Borrower secured by property and subject to interest from date of disbursement. Please confirm that when the borrower reimburses the LPI premium to the Lender either directly or via the servicer, this provision does not apply. Please also confirm and clarify that if the property goes to foreclosure, the LPI premium payment is reimbursed from the mortgage guarantor, such as generally Fannie Mae or Freddie Mac.*

CEJ Response: This description is essentially correct. To be more specific, for non-blanket coverage, the LPI insurer charges a premium to the servicer – who is the named insured – for coverage issued under the LPI master policy. There is then a separate transaction in which the servicer assesses a charge to the borrower allegedly for LPI.

The charge to the borrower is added to the borrower's escrow account for insurance and taxes. Once the LPI charge is added to the borrower's escrow account, the monthly mortgage payment is typically revised to an amount sufficient to pay off / accumulate the LPI charge over the year. While the LPI charge remains part of the escrow, there is no additional debt or interest. The LPI charge becomes additional debt if the loan goes into default. So, if a borrower makes the monthly payments covering the LPI charge, no additional debt or interest is added to the loan.

If the loan goes into default and becomes REO (real-estate owned), the servicer will proceed to foreclosure and eventually sell the property. The owners of the loan or the guarantors of the loan are responsible for reimbursing the servicer for all costs incurred by the servicer in servicing the loan and which have not been reimbursed to date – including unpaid LPI charges.

2. *The following questions relate to slides 14 and 16 and the conclusion that since mortgage owners/investors pay a fee to servicers for insurance tracking, inclusion of these expenses in LPI rates means the borrower pays for this service twice.*

   A) *Slide 14 indicates Lender/Servicer is paid by Mortgage Owners to perform tracking. Please document if this is a separate fee from the loan agreement or if it has another source and if so what is source of the funds and to whom is it paid.*

CEJ Response: As described in the text on mortgage lending ("Pinkowish"), a servicer is paid a fee for performing nearly all servicing activities. Exceptions – meaning additional charges beyond the servicing fee – may occur for foreclosure-related activities. But escrow administration is clearly part of the services covered by the servicing fee. And the purpose of escrow administration is, among other things, to ensure the property serving as collateral is protected. So, escrow administration includes not only monitoring voluntary insurance, but collecting periodic payments from borrowers (in the escrow account) to pay the voluntary insurance premium and property taxes when due. The servicer can only carry out the insurance responsibilities if the servicer is tracking insurance coverage. Again, the fact that the servicer contracts out this responsibility to a LPI vendor does not make the expenses associated with responsibility a LPI expense.

B) *Document whether insurance tracking is done by the Lender only, by the Servicer only or if contractually done by another party, including the LPI insurer.*

CEJ Response: The documentation for this will be found in agreements between the servicer (or lender if the lender is servicing its own loans) and the LPI vendor. Historically, the largest banks were also the largest mortgage servicers (Wells Fargo, Bank of America, Chase, Citi). Much of the servicing of loans owned by others has moved to non-bank servicers like Nationstar and Ocwen.

However, if the Lender uses a servicer, then any agreement for loan tracking services will be between the servicer and the LPI vendor providing loan tracking.

It is also important to note that Assurant is in a class by itself in the LPI market. Assurant provides LPI for some 75% of mortgage loans, counts the largest servicers among its clients and has publicly stated that it requires the servicer to outsource tracking to Assurant as a condition of providing LPI.

The remainder of the market – which includes thousands of small and medium sized banks and credit unions – are served by a handful of LPI vendors typically structured as a managing general agency that shops for an LPI insurer. If you review the websites for these second tier LPI vendors – National General[1], Proctor Financial[2], SWBC, Loan Protector[3], Miniter[4] – you'll see that these vendors offer LPI without tracking, offer tracking only, offer LPI with tracking and several other options. You will also see options for blanket LPI coverage without tracking or individual charges to borrowers.

C) *Please document whether the tracking expenses included in an LPI rate filing are those amounts paid by the insurance company for tracking activities they perform for the servicer or if there are separate tracking activities that the insurance company does, and are these tracking expenses done by the servicer not related to company activities and actual expense.*

CEJ Response: Respectfully, this question is asking Assurant to admit the company engages in kickbacks in order to win and maintain business. The explanations given by various LPI vendors over time as justification for using these expenses are factually incorrect, but difficult for insurance regulators not versed in the details of mortgage servicing to spot. That misinformation was successful in thwarting regulatory intent with the original NY and FL LPI settlements and was successful again in the multi-state settlement which, again, codified kickbacks by allowing the inclusion of expenses in LPI rates for activities unrelated to the provision of LPI

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1 http://www.nationalgeneral.com/lenderservices/
2 http://www.pfic.com/insurance-products/
3 https://www.loanprotector.com/insurance-solutions/
4 https://www.miniter.com/our-services/information-for-loan-servicers/

D) *Slide 16 indicates mortgage owners/investors pay a fee to servicers that covers insurance tracking and so to include insurance tracking in LPI rates means borrowers pay the servicer twice for the same activity. Please explain in detail how this result occurs and what the contractual relationship of the parties is and who pays whom for what services which result in double paying by the borrower.*

CEJ Response: In simple terms, the income to a mortgage owner is the interest on the loan paid by the borrower. The mortgage owner pays the servicer a fee which is taken out of this interest payment. The typical mortgage servicing fee is 0.25% of outstanding loan balance. So, if the mortgage interest rate is 5.00%, the servicer collects the payment and remits 4.75% of the interest portion of the monthly payment plus the principal repayment portion of the monthly payment.

As discussed above, and explain by Pinkowish, this fee covers escrow administration and, consequently, covers insurance tracking. So the servicer is paid, through the servicing fee, for insurance tracking (as well as other activities related to protecting the property serving as collateral for the loan). If the LPI rates include tracking expenses, then the servicer is paid twice for tracking because the servicer is reimbursed – either by the borrower or mortgage owner or mortgage guarantor – for LPI premium s the servicer has paid. Thus, the servicer is paid twice for tracking – once through the servicing fee and once through the amounts paid to the servicer for "LPI."

3. *The second paragraph of Slide 16 indicates that including tracking in LPI rates means that only those borrowers charged for LPI insurance pay for these services instead of charging all borrowers for tracking expenses. Is the basic proposal, then, to remove tracking expenses from LPI premium and instead have all borrowers pay tracking expenses as part of the loan transaction? We specifically request that Assurant respond to this concept and identify any concerns that would be created by changing how tracking is done and paid for and by whom and the feasibility of this concept.*

CEJ Response: All borrowers already pay for tracking because the interest payment borrowers make covers the servicing fee paid to servicers which covers the insurance tracking activities. This is clearly reasonable and appropriate because while insurance tracking is used to identify a small percentage of properties whose insurance has lapsed and for whom LPI is placed, the vast majority of tracking activity is related to monitoring insurance to be able to disburse funds from escrow to pay renewal premiums.

The argument to exclude tracking expenses from LPI rates is based on the fact that tracking is not related to the provision of LPI and, consequently, is an unreasonable expense. It is also unfair for several reasons:

- it causes services to be paid twice for tracking,
- it imposes this second tracking expense on a small number of borrowers for whom LPI is placed even though tracking is a portfolio-wide expense and
- it creates unfair competition because the largest LPI vendor has far more resources to provide considerations to servicers as an inducement to win or maintain business. This is obvious from a market in which one LPI vendor has a 75% market share.

Attached is the financial supplement to the 2018 Q3 Assurant quarterly financial report. The supplement shows, on page 16, that Assurant tracks 35.1 million mortgage loans out of countrywide total of about 50 million mortgages. This is increase of 5.6 million loans tracked – over 10% of the entire market – since 2010Q1 when Assurant tracked 29.5 million loans. Despite the tremendous shifts in mortgage servicing among large banks and non-bank servicers, Assurant has gown its market share.

Of course, the most compelling evidence of the kickback structure of LPI markets are the low loss ratios – loss ratios for LPI half of those for homeowners, despite no individual underwriting, group policies covering hundreds of thousands of properties and lesser coverage (no contents or additional living expenses). The low loss ratios are not a function of significantly higher reinsurance costs nor higher average claim costs since average claim costs for LPI are about the same as for homeowners insurance. Despite demonstrably lower expenses for marketing and underwriting a group policy compared to hundreds of thousands of individual property policies, actual expense ratios for LPI are far higher than for homeowners. This can only be explained by the fact that kickbacks are being included in expense provisions in filings submitted by LPI insurers.

4. *Questions on Tracking and Exposure management:*
   A) *Slide 17 concludes that tracking is not used for exposure management because schedule rating has charges based on Aggregate Loan Portfolio Characteristics, not individual loan tracking information. Does pricing for characteristics mean tracking is not used for risk or exposure management?*

CEJ Response: First, the schedule rating examples are evidence – facts – that demonstrate that tracking is not used for "exposure management" or "risk management." Assurant's claims, in contrast, are claims unsupported by empirical evidence. While some of the false claims made by Assurant are difficult for insurance regulators to spot since a knowledge of mortgage servicing is needed, the false nature of the 'risk management" claims should be easy for insurance regulators to spot.

During the October 31, 2018 call, Assurant's alleged two rationales for including tracking as a LPI expense -- to keep track of amounts owed them by the servicer and for reinsurance requirements ("we provide 50 reinsurers data on our exposures"). The Assurant arguments confuse their exposure with their in-force coverages.

Assurant's exposure is comprised of all the properties serving as collateral for loans in the servicer's portfolio because coverage may be issued from the master policy for any of these properties if voluntary coverage lapses. That is why risk management and underwriting is performed on the basis of loan servicing portfolio characteristics and not individual loan tracking data. While there will be significant churn in the actual properties insured over, say, a 12 month period within a particular portfolio, the aggregate characteristics of the portfolio provide information for accurate exposure management. Based on, for example, the type of loans, whether escrowed or not, the average size of loans, percentage in late pay status and other characteristics identified in scheduled rating worksheets, Assurant (or reinsurers) can accurately gauge their risk exposure -- even though they don't know with any certainty what specific properties will actually be insured in six months.

In contrast, policy administration is what insurers use to keep track of coverages issued, premiums charged and premiums owed. In the case of LPI -- depending on the particular servicer loan portfolio -- perhaps 1% to 3% of exposures (properties on all loans) will have coverage in place at any given time. An insurer uses a policy administration system to keep track of insurance in place and premiums charged and premiums owed -- that is not the purpose or use of insurance tracking. Insurance tracking is designed to identify whether and which properties in the entire portfolio have required insurance coverage. An insurer does not use insurance tracking to keep track of premium owed by the servicer to the insurer. While a LPI insurer like Assurant may require that the servicer utilize Assurant for tracking because Assurant wants to be sure that lapsed loans are accurately identified, that requirement by Assurant does not alter the fact that tracking is a servicer responsibility and not an appropriate expense in LPI rates or LPI charges to borrowers.

Regarding reinsurance, the reports that Assurant routinely provides to reinsurers -- and which Assurant uses for claims in the event of catastrophes -- are, again, policy administration reports showing which specific properties have LPI in place. Insurance tracking is not part of our used for claim settlement because tracking covers all loans in a portfolio while claims can only occur with coverage in force at the relevant time and information on that coverage in force comes from policy administration and not insurance tracking. And while it is useful for a reinsurer to know the characteristics of an entire loan portfolio so the reinsurer can perform its own risk and exposure management, at the time of a catastrophe, the reinsurer is interested in the actual properties with coverage in place because it is only those properties -- not the entire portfolio subject to insurance tracking -- that may cause claim costs sufficient to trigger reinsurance payments.

B) *Assurant indicated that exposure management is used based on trends in the actual LPI portfolio of actual insureds. Please confirm this is true and if true how is the potential liability that the master policy coverage could significantly change, such as in times of financial crisis, accounted for?*

CEJ Response: We expect Assurant will not provide any actual evidence that might be reviewed by CEJ. CEJ would point regulators to information Assurant provides to investment analysts as evidence supporting CEJ's explanation that risk management is based on portfolio characteristics. On the same page 16 of the 2018 Q3 Assurant earnings release supplement, you will see that Assurant provides data on loans tracked, average placement rate, average insured value, percentage of REO properties and spread of exposure by region. "Spread of exposure refers to the location of loans in the loan tracking portfolio, not to the spread of LPI coverages in place – "Geographical spread of exposure is based on the Company's assessment of total insured value for all of Global Housing."

C) *Assurant also indicated that in a rate filing, the tracking expense is needed for exposure management. Please confirm this is true and that the actual tracking expense used in a rate filing does not include escrow management or loan draft cost on voluntary policies*

CEJ Response: Again, we expect Assurant will not provide any actual evidence that might be reviewed by CEJ. However, it is unclear what OIR seeks by asking Assurant to "confirm that this is true" and that expenses proposed in the rate filing does not include escrow management or loss draft expenses. Asked differently, what evidence should Assurant provide to make this confirmation? A statement by Assurant "confirming" this is clearly not evidence. We again point regulators to the empirical evidence – despite a product that should have far lower administrative, sales, underwriting and policy issuance expenses as a percentage of premium than homeowners insurance, expense provisions in LPI rate filings are significantly higher. This can only be explained by proposed expense loads in LPI rate filings including amounts for activities unrelated to the provision of LPI.

D) *Finally, Assurant further indicated that one of the reasons that tracking expenses should be included in LPI rates is that Assurant performs exposure management better. Please explain this and explain what activities Assurant engages in that the servicer does not and what are they doing relative to tracking expense that is better.*

CEJ Response: We have refuted this claim, above.

5. *Explain how implementation expenses are a kickback since implementation expenses can be due to an insurer obtaining a new book of business with attendant IT system and other costs that over time need to be recovered.*

CEJ Response: The proposed model and multi-state regulatory settlement include the following exception to the anti-kickback provision of the model:

> The prohibitions and requirements set forth in this paragraph shall not preclude an insurer or insurance producer from reimbursing implementation expenses incurred by a lender/servicer.

First, the implementation expenses referenced are those of the lender/servicer, not the insurer. The insurer's implementation expenses would be part of general, administrative or sales expense – just as they would be for any insurer for any line of business.

Second, this provision undercuts the general anti-kickback provision by permitting the insurer to provide a consideration to the lender/servicer in exchange for the lender/servicer selecting the LPI vendor. We are a bit puzzled by this provision and the question, since paying a lender/servicer for "implementation expense" is clearly a consideration and a kickback – the LPI vendor is rebating something of value to the insured in exchange for securing the business. If this were proposed for any other line of business, there would be no question of its illegality as a rebate. Suppose Allstate started offering implementation rebates – cash payments – to consumers who purchased a telematics auto insurance policy to cover the consumer's "implementation costs."

Third, in addition to being a glaring kickback, this provision promotes unfair competition because the largest LPI vendor has the greatest ability to provide the greatest "implementation expense reimbursement."

Fourth, the fact that Assurant was able to convince a number of regulators to include this gaping kickback loophole in the regulatory settlement agreement is powerful evidence of the need for an absolute ban on any consideration by the insurer to the servicer other than the protection of the property servicing as collateral for the loan. Permitting things like "implementation expenses" if they can be satisfactorily explained will lead to consumer abuse and unreasonable rates and charges -- the insurer will always explain or shade the explanation in an effort to make any expense seem in compliance with statutory requirements and they are in the cat bird seat of information asymmetry -- they know all the details and how to frame things to get by the regulator, while the regulators, particularly in states where the insurance regulator is separate from the banking regulator, have limited knowledge of mortgage servicing and limited time and resources to do forensic accounting for each rate filing.

Fifth, what "implementation expenses" of the servicer do regulators believe are reasonably included in LPI rates? Suppose the servicer incurs costs to connect its mortgage servicing system to the LPI vendor's data system? That is a cost of the servicer and part of the servicer's calculus to use a tracking vendor or switch from an existing tracking vendor.

Sixth, an exception for "implementation expenses" – or tracking expenses – will lead to a lack of uniformity across the states, based in large part on the size and resources of the state to understand and review justifications provided by the LPI insurer. While there are many reasons for rate filing considerations to vary by state – catastrophe exposure, underwriting restrictions – differences in what constitutes a reasonable general, administrative or sales expense for insurance typically sold through countrywide agreements is surely not an expense that should vary by state.

6. *Please explain the "loophole" concern discussed on Slide 27 regarding an LPI Insurer buying an agency since the model law indicates that an insurer or producer cannot issue LPI on servicing done by the insurer, insurer producer or affiliate of insurer or insurer producer.*

CEJ Response: Attached is a prospectus for Carrington Mortgage issued in Ireland. The prospectus explains that Carrington sold its insurance agency to a third party for an amount equal to expected commissions from LPI. So, instead of an affiliated agency receiving LPI commissions – now a prohibited act – Carrington received these same commissions as an upfront payment with the LPI insurer continuing to pay "commissions" to the third party. Below are relevant excerpts from the prospectus describing the transaction and the warning to investors that the transaction may be found to be illegal.

It would be useful for insurance regulators to examine transactions in which LPI vendors have purchased servicer-affiliated insurance agencies or other servicer-affiliated businesses to determine if such purchases were a consideration for securing the LPI business of the servicer.

Excerpts from Carrington Mortgage Prospectus

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14. DEFERRED REVENUE
Effective November 28, 2012, Carrington Insurance Agency, LLC ("CIA"), formerly known as Telsi Insurance Agency, LLC, entered into a contract to transfer their rights, title and interests to insurance commissions placed on or after the aforementioned effective date. The contract stipulates a minimum required production of $125.0 million in policies placed by CIA at a commission rate of 17%, in exchange for $21.25 million in cash paid to CIA on the effective date. CIA recorded the cash received as deferred revenue which is earned as new policies are placed by CIA. The deferred revenue amount in the accompanying consolidated statements of financial condition was approximately $19.0 million at September 30, 2013 (unaudited) and $21.2 million at December 31, 2012, respectively.

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Insurance Services
Carrington Insurance Agency, LLC ("CIA"), a wholly owned subsidiary of CRES, acts as the insurance agent for placing insurance coverage to protect loans and foreclosed properties serviced by CMS, and maximizing claims recoveries form insurance underwriters for REO properties. CIA receives a commission amount equal to 15% of the net policy amount paid. During the nine months ended September 30, 2013 and 2012 (unaudited), and for the years ended December 31, 2012 and 2011, CIA received approximately $3.0 million, $2.4 million, $3.3 million and $4.5 million, respectively, for performing these services.

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Certain regulators, including the New York State Department of Financial Services, have undertaken investigations into the business of lender placed insurance, also known as "force-placed insurance". Specifically, these regulators have taken the position that where a loan servicer imposes a force placed policy, and the force placed insurance provider pays a commission to an insurance agency affiliated with the servicer imposing the policy, such commission may constitute an improper "kickback". Should any regulator decide to take action, we may be forced to pay restitution, potentially including the return all or a portion of the pre-paid fees paid to us by obligors under forced-place insurance policies. In addition, in connection with the sale of our insurance agency business, we may be required to refund to the purchaser up to $18,994,510, as of September 30, 2013, of the consideration received from such sale if target levels of net written premiums are not produced within specified periods. Please see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations

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On November 28, 2012, CRES and Carrington Insurance Agency, LLC entered into an asset purchase agreement with a third party buyer to sell certain assets and liabilities of Carrington Insurance Agency, LLC's insurance agency business for total consideration of $21,250,000. Under the agreement, the sellers may be required to refund to the buyer up to $18,994,510, as of September 30, 2013, of the consideration received from such sale if target levels of net written premiums are not produced within specified periods. Please see "Risk Factors—Risks 82
Relating to Our Business—Real Estate—We may be subject to significant losses relating to refunds from our insurance referral program."

Page 116 of PDF
Certain regulators, including the New York State Department of Financial Services, have undertaken investigations into the business of lender placed insurance, also known as "force-placed insurance." Specifically, these regulators have taken the position that where a loan servicer imposes a force placed policy, and the force placed insurance provider pays a commission to an insurance agency affiliated with the servicer imposing the policy, such commission may constitute an improper "kickback." Should any regulator decide to take action, we may be forced to pay restitution, potentially including the return all or a portion of the pre-paid fees paid to us by obligors under forced-place insurance policies.

7. *Please explain how this "loophole" on Slide 27 relative to below cost outsourced services is a loophole and how NY DFS closed the loophole.*

The New York DFS promulgated a regulation to memorialize the provisions of the 2013 settlements between NY DFS and LPI insurers (Assurant, Balboa, QBE). The settlements and the original NY DFS regulation included the provision:

> 10. The New York FPI Companies shall not provide free or below-cost outsourced services to servicers, lenders, or their affiliates, provided, however, that outsourced services do not include expenses associated with tracking functions that the New York FPI Companies **incur for their own benefit to identify and protect themselves from**
> **(a) exposure to lost premium and losses on properties on which no other insurance coverage is in effect** or
> (b) administrative costs associated with providing and subsequently canceling force-placed insurance on properties on which force-placed insurance is not required. (emphasis added)

The NY DFS quickly found problems with the settlement language so when the initial LPI rule was promulgated, it included:

> <u>227.1 Definitions</u>
> (f)(1) *Insurance tracking* means all activities related to determining whether a borrower has in place hazard insurance that complies with the mortgage loan contract's requirements to maintain hazard insurance, including:
> (i) developing and maintaining a database used by a servicer to track required hazard insurance on borrowers' loans;
> (ii) maintaining hazard insurance information on behalf of a servicer, including in a servicer's mortgage servicing system;
> (iii) inputting insurance information on new loans into an insurance tracking database or a servicer's mortgage servicing system;
> (iv) all communications by a servicer or on behalf of a servicer with a borrower's voluntary hazard insurer or voluntary hazard insurance producer;
> (v) all communications by a servicer or on behalf of a servicer with a borrower concerning required hazard insurance, including the written notices required by section 227.2 of this Part and communications concerning charging the borrower's account for insurance; and
> (vi) all call center and other customer service operations related to the communications described in subparagraphs (1)(iv) and (1)(v) of this paragraph.
>
> (2) The term *insurance tracking* shall not include:
> (i) issuing force-placed insurance or monitoring the continuing need for force-placed insurance after (*a*) voluntary hazard insurance covering residential real property has lapsed or been cancelled, or (*b*) an insurer, insurance producer or affiliate has not received evidence of existing insurance coverage that complies with section 227.4 of this Part; or
> (ii) performing administrative services associated with cancelling force-placed insurance on properties on which force-placed insurance is not required.
>
> <u>227.6 Prohibited Practices</u>
> (g) No insurer, insurance producer, or affiliate shall provide insurance tracking to a servicer or a person or entity affiliated with a servicer for a reduced fee or no separately identifiable charge.

> <u>Section 227.7 Minimum Loss Ratio and Rate Filings</u>
> (f) An insurer shall not include as an expense in a force-placed insurance rate filing any expense incurred in connection with insurance tracking.

CEJ Conclusion

Since the 1996 adoption of the NAIC Creditor-Placed Insurance Model Act, over 20 years have passed of giving the benefit of the doubt to insurers through that Model Act and we've seen the horrific results -- billions of dollars of kickbacks from LPI insurers to servicers at the height of the financial crisis exacerbating the pressure on victims of predatory lending.

It's long-past time to give the benefit of the doubt to consumers. We know what the downside of permitting tracking and implementation expenses in the model law will be -- more of the same kickbacks from LPI insurers to servicers that inflate LPI rates and LPI charges to the most vulnerable consumers. What is the downside of not including these exemptions -- of crystal clear prohibitions against any consideration by the LPI insurer other than protection of the property serving as collateral for the loan? Prohibiting these "expenses" in LPI rates and LPI charges to borrowers will not stop LPI vendors from performing these activities -- it will simply move the expenses to the proper place outside of the insurance transaction. Given the huge disparity in potential harm to consumers vs. potential harm to insurers and servicers, it should be an easy choice to give the benefit of the doubt to consumers and prohibit all considerations by the LPI insurer to the servicer.

Attachments

1. CEJ Presentation to Florida Office of Insurance Regulation, October 31, 2018
2. Assurant 2018 Q3 Financial Supplement
3. Assurant 2010 Q4 Financial Supplement
4. Carrington Holding Company Prospectus
5. New York Department of Financial Services – Assurant LPI Consent Order, 2013
6. Florida Office of Insurance Regulation – Assurant LPI Consent Order, 2013
7. New York Department of Financial Services 11 NYCRR 227, Insurance Regulation 202, Regulation of Force-Placed Insurance

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF FLORIDA
TALLAHASSEE DIVISION

SIMEON PENTON, on behalf of himself and all others similarly situated,

Plaintiff,

v.

Case No. 4:18-cv-00450-MW-CAS
JURY TRIAL DEMANDED

CENTENNIAL BANK,

Defendant.

AFFIDAVIT IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION

BEFORE ME, the undersigned authority, duly authorized to administer oaths, personally appeared CHAD BROWN ("Affiant") who, after being first duly sworn, deposes and says:

1. Affiant is competent, of the age of majority, and has the authority and personal knowledge necessary to make this Affidavit.

2. Affiant is the Loan Servicing Manager and Vice-President of Defendant, Centennial Bank (the "Bank").

3. Affiant's job responsibilities include the administration and management of various functions relating to the servicing of secured loans

EXHIBIT 2

in the Bank's portfolio. Affiant is familiar with the policies and procedures of the Bank relating to the processing and servicing of loans, including with respect to force-placement of insurance coverage ("FPI") to protect the Bank's interest in real or personal property a borrower pledges to secure repayment of a loan.

4. Affiant has reviewed the books and records of the Bank as such books and records relate to borrowers like Plaintiff, Simeon Penton ("Penton") for which the Bank has force-placed insurance coverage during the relevant Class Period[1] potentially spanning from 2011 through October 2018. The books and records related to these borrower loan accounts, which include force-placed insurance premiums, were made in the normal course of regularly conducted business activity, at or near the time of the occurrence of the events, created by or from a person with personal knowledge of the events, and in connection with the Bank's regular practice of making such a record. These books and records accurately reflect the total premium added to an individual borrowers' loan account upon the Bank's force-placement of insurance coverage, including any adjustments later recorded following

[1]Unless otherwise indicated, capitalized terms have the same meaning ascribed in the Second Amended Complaint (ECF 57).

any cancellation of coverage and ensuing reimbursement of the Bank by the insurer for the prorated portion of the premium corresponding to the cancelled period of the policy (the "Net Written Premium").

The Bank's Lending Relationship with Penton

5. On September 7, 2005, Penton executed and delivered a promissory note to the Bank's predecessor, Gulf State Community Bank in the original principal sum of $200,000.00 that matured on September 7, 2007 (the "Note"). The Bank renewed the credit extended pursuant to the Note on various occasions. To secure repayment of the Note, Penton executed and delivered a mortgage (the "Mortgage") pursuant to which Penton granted the Bank a mortgage lien encumbering the following-described real property:

> UNIT NUMBER 103 OF MARINER'S VIEW CONDOMINIUMS AS PER THAT CERTAIN DECLARATION OF CONDOMINIUM RECORDED IN OFFICIAL RECORDS BOOK 865, PAGE 369 OF THE PUBLIC RECORDS OF FRANKLIN COUNTY, FLORIDA
> (the "Property")

A true and correct copy of the Note and Mortgage is attached as **Composite Exhibit 2-A**.

cure inadequate coverage. Determination of adequacy of coverage differs only slightly between flood and other hazard policies, again due to NFIP implementing regulations. These regulations mandate coverage in the amount of the lesser of (i) $250,000.00; (ii) the outstanding principal balance of the loan; and (iii) insurable value of the collateralized structures. The Bank's flood coverage calculations conform to this regulatory mandate. *See* **Composite Exhibit 2-B** at p. 2.

9. Following is a sequence of events representative of Penton's FPI experience with the Bank: (i) the Bank's vendor notifies Penton that the Bank had not received evidence of flood coverage providing forty-five days to provide the Bank such evidence; (ii) at the conclusion of the forty-five day notice, the Bank force-placed adequate coverage per the NFIP regulations based on the outstanding loan balance and insurable value of the collateralized structure; (iii) Penton provided the Bank evidence of coverage that was inadequate based on the Bank's calculation; (iv) the Bank partially cancelled the FPI coverage it had obtained and gave Penton notice that the coverage provided remained inadequate providing forty-five days to provide evidence of adequate coverage; and (v) at the conclusion of the forty-five day period when Penton had not provided evidence of adequate

coverage, the Bank force-placed for the difference. *See* **Composite Exhibit 2-B**

Net Written Premiums

10. The Bank's vendor in charge of portfolio insurance monitoring maintains cross-reference information to evaluate the placement of force-placed insurance. Because there is no reasonably practicable method for searching the entirety of the Bank's portfolio, the Bank has compiled its records first by assessing all force-placed insurance events.

11. Over the period from January 1, 2011 through October 1, 2018, the Bank's books and records relating to borrower loan accounts that include force-placed insurance premiums are substantially voluminous, and it would impose a staggering administrative burden to examine these books and records because they involve approximately 6,971 different borrower loan accounts and approximately 15,575 separate force-placed coverage events. A true and correct copy of the Bank's spreadsheet itemizing the details of the various coverage events memorialized in the Bank's books and records is attached as **Exhibit 2-C** (the "FPI Summary").

12. During the Class Period, the Bank experienced a total of 15,575 force-placed coverage events include every conceivable form of insurance

coverage for the Bank's loan portfolio, from hazard, wind, and flood insurance for real property collateral to coverage for personal property like automobiles and other vehicles, and business insurance. A total of 2,620 of the events concerned non-real property insurance.

13. Among the 15,575 separate force-placed coverage events, 5,142 of these events resulted in full reimbursement of the force-placed insurance premium the Bank funded such that the loan account balances for these borrowers do not include any cost for force-placed insurance relating to these events. Excluding full-reimbursement events, there are 10,433 coverage events and 4,380 distinct account numbers within the Class Period. *See* **Exhibit 2-C**

14. Further excluding non-real estate insurance, the balance of 8,700 force-placed coverage events resulted in Net Written Premiums that the Bank paid in the total amount of $11,494,507.94. *See* **Exhibit 2-C**.

15. The following table summarizes a break-down of the 8,700 events and $11,494,507.94 figure by one of three potential account dispositions: (1) the account has been closed or written off and the bank recovered its incurred costs for the force-placed coverage event (the "Paid" events); (2) the account has been closed and the bank charged off a net loss

on the account (the "Unpaid" events); or (3) the account remains open and active or the disposition is not yet settled or determinable from the bank's records (the "Active-Owe" events):

		Real Estate	Non-Real Estate	All Insurance
Paid	**Count**	2529	663	3192
	Total	$3,056,272.66	$533,843.55	$3,590,116.21
Unpaid	**Count**	1515	287	1802
	Total	$2,925,983.99	$375,386.04	$3,301,370.03
Active-Owe	**Count**	4656	783	5439
	Total	$5,512,251.29	$699,833.96	$6,212,085.25
Total	**Count**	8700	1733	10433
	Total	$11,494,507.94	$1,609,063.55	$13,103,571.49

16. During the Class Period, and focusing solely on real-property insurance coverage events, Centennial recovered all amounts owed on closed accounts attributable to approximately 62.54% of the coverage events and 51.09% of the net written premiums that it initially paid.

FPI Servicing Costs

17. In October 2015, the Bank entered into an agreement (the "OSC Agreement") with Overby-Seawell Company ("OSC") pursuant to which the Bank engaged OSC to serve as its insurance tracking vendor and perform the duties Southern Pioneer had previously performed for the Bank with respect to FPI.

18. The OSC Agreement includes a comprehensive schedule of services and administrative functions that OSC agreed to provide the Bank with respect to its loan portfolio FPI processes. In consideration of these services, the OSC Agreement includes a fee schedule imposing (i) a monthly fee of $0.28 for each loan monitored within the portfolio; (ii) the actual cost of postage and delivery fees incurred in connection with borrower correspondence regarding an FPI event; and (iii) an hourly rate of $150.00 for tasks that require additional programming support.

19. The Bank's loan portfolio subject to these loan monitoring services consists of approximately eighteen thousand (18,000) loans, although that figure fluctuates.

20. Following the OSC Agreement Amendment, Affiant investigated the fees charged by comparable vendors as OSC. Affiant determined that the marketplace for insurance-portfolio tracking services can be broadly characterized into two tiers of service. In the higher tier, the tracking services are such that the Bank is not necessary for virtually any step of the process. From my investigation, a reasonable range of cost for higher-tier services is approximately $0.80 to $0.90 per loan per month. In the lower tier, the services provided require substantial interaction and effort by bank

employees. From my investigation, a reasonable range of cost for lower-tier services is approximately $0.40 to $0.50 per loan per month. Affiant would characterize the Bank's current vendor as providing services in the lower tier.

FURTHER AFFIANT SAYETH NAUGHT.

STATE OF ARKANSAS
FAULKNER COUNTY

CHAD BROWN, AFFIANT

The foregoing instrument was sworn to and acknowledged before me this 9th day of September, 2020 by CHAD BROWN, Loan Servicing Manager and Vice-President of Centennial Bank who ( ) provided ____________________ as identification bearing identification number __________________ or who (✓) is personally known to me.

Allison Benedetti

NOTARY PUBLIC

[NOTARIAL SEAL]

ALLISON BENEDETTI
NOTARY PUBLIC
FAULKNER CO., ARKANSAS