NAIC Hearing on Private Lender-Placed Insurance

Testimony Submitted on Behalf of the American Bankers Insurance Association

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Mr. Chairman: The American Bankers Insurance Association ("ABIA") appreciates the opportunity to present testimony on the current state of the lender-placed insurance industry to the Property and Casualty Insurance (C) Committee and the Market Regulation and Consumer Affairs (D) Committee. ABIA represents banks that are actively engaged in the business of insurance, principally as producers; insurance companies; and third party administrators that provide insurance products and services to banks. ABIA is a subsidiary of the American Bankers Association.

In response to the recent national mortgage crisis, federal and state legislators and regulators, and state attorneys general, have, or will soon be instituting, new requirements and regulations for lender-placed insurance. Therefore, further action by the NAIC at this time may result in unintended consequences for homeowners, mortgage investors, and lenders. We urge the NAIC to allow the existing reforms time to work and reassess whether action is needed at a later time. In the balance of my statement, I will provide some basic information on lender-placed insurance and the existing regulation of the product.

I. Current Use and Operation of Lender-Placed Insurance

Lender-placed insurance provides important protections to homeowners, residential mortgage lenders, and investors, and helps support the nation's housing finance market. Housing lenders and housing investors, including Fannie Mae, Freddie Mac (collectively "GSEs"), and the Federal Housing Administration, require borrowers to maintain homeowners insurance and flood insurance (if applicable). Insurance protects the lender's or investor's collateral – the home – by providing funds to repair or rebuild it following a loss. Mortgage servicers are required to track the status of each borrower's coverage and notify borrowers when the tracking process indicates the borrower's insurance policy has terminated. To the extent a borrower, even after such notice, fails to maintain the required coverage, lenders and investors are exposed to a significant risk of loss.

To mitigate that risk, lenders and investors, or their designated mortgage servicers, typically agree with borrowers to escrow insurance premium and remit payment for the required hazard or flood policy directly to the borrower's insurance carrier. Even if funds are not available to pay the premium from the escrow account, mortgage servicers will still advance the necessary funds to renew the policy. Only when the borrower or carrier has intentionally terminated the policy will an escrowed borrower be lender placed. For non-escrowed loans, borrowers have elected not to give mortgage servicers the authority to take action related to the borrower's policy; thus, mortgage servicers do not have the ability to renew the borrower's existing policy,[1] but do still follow the notice process and urge the borrower to maintain coverage.

In short, mortgage servicers advance their own funds to pay for the voluntary insurance. Mortgage servicers obtain lender-placed insurance only as a *last resort*, pursuant to the terms of the mortgage agreement the borrower entered into, to protect the investor's collateral. Without this insurance of last resort, lenders and investors' costs would rise significantly due to uninsured losses, and thus would either reduce funding for mortgages, or cause lenders and investors to compensate for their increased costs by raising the costs of mortgage credit.

The rise in defaults and foreclosures since 2008 has caused more borrowers to let their voluntary insurance lapse and increased the need for lender-placed insurance. While consumer advocates have criticized this increase in LPI policies as merely a profitable boom in business, the truth is that defaults and foreclosures actually present heightened risk of loss for mortgage investors. Properties in foreclosure often are neglected or abandoned, which increases the risk of loss beyond that of a performing loan, thus impairing the value of the property. Lender-placed insurance is a means of ensuring the preservation of the collateral's value. During times of widespread economic distress, it becomes especially critical to maintain the value of the collateral and preserve the solvency of housing lenders, particularly depository

[1] The National Mortgage Servicing Settlement, referenced below, attempts to address this issue by requiring mortgage servicers to include an offer to set up an escrow account in the lender-placed insurance notices a borrower receives.

institutions, because of safety and soundness requirements. Even in this difficult economy, most borrowers honor the promises they made in the mortgage agreement to keep the collateral insured, which means that, for most mortgage servicers, only about two and a half percent of all mortgages have activated lender-placed insurance, and that percentage will likely decrease as the housing market recovers.

Mortgage servicers require that insurers underwriting lender-placed insurance accept any property, in any condition, regardless of age, prior damage, prior insurance claims, exposure to hurricanes, floods, wildfires, sinkholes, and other underwriting factors. Consequently, underwriting and pricing tools typically available to insurers of homeowners, such as premium adjustments based on elevation, proximity to brush, proximity to the coastline, fire protection, burglary protection, and hurricane damage mitigation, are not available for lender-placed carriers. These unique exposures and elevated risks mean that lender-placed insurance rates are higher than the rates a borrower could otherwise obtain in the traditional market for a fully underwritten product.

II. Existing Laws and Regulations Governing Lender-Placed Insurance

Lender-placed insurance rates, terms and conditions are currently subject to robust oversight by state regulators. The passage of the Dodd-Frank Act also brought about enhanced federal involvement in the regulation of lender-placed insurance.

A. State Laws

A number of existing state laws and regulations currently govern lender-placed insurance. State insurance regulators already have authority to review lender-placed insurance rates and forms and the solvency of the admitted insurers offering lender-placed insurance. They also oversee the insurance producers, including those associated with lender-placed insurance transactions, with the commissions tied to the sale of lender-placed insurance being subject to existing state regulations.

Notably, the NAIC has already undertaken a significant review of the practices and procedures related to collateral protection insurance, and has developed a model Creditor-Placed Insurance Act (the "Model Act"),[2] which has been adopted by a number of states.[3] The Model Act specifically governs: policy terms; the payment of premiums; evidence of coverage; filing and approval of rates and forms; prohibited coverage; refunds; and compensation paid to insurance producers, among other items.[4] While the Model Act as drafted applies only to personal property, five states have determined that its provisions were sufficiently applicable to real property to apply it to such collateral.[5]

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[2] NAIC Model Laws, Regulations and Guidelines 375-1, Creditor Placed Insurance Model Act (2012).

[3] The Model Act, or legislation substantially similar to it, has been adopted in 12 states (Arkansas, see, AR ST § 23-101-101 *et seq*.; Illinois, see 815 IL. COMP. STATS. § 180/5 *et seq*.; Michigan, see MICH. COMP. LAWS § 500.1601 *et seq*.; Mississippi, see MISS. CODE ANN. § 83-54-1 *et seq*.; Missouri, see MO. REV. STAT. § 427.110 *et seq*.; New Jersey, see N.J. REV. STAT.§ 17:16V-1 *et seq*.; New Mexico, see 13 N.M. ADMIN. CODE § 18.3.1 *et seq*.; Oregon see OR. ADMIN. R. 836-062-0001 *et seq*.; Tennessee see TENN. CODE ANN. § 56-49-101 *et seq*.; Texas, see TEX. FIN. CODE Sec. 307.001 *et seq*.; Washington, see WASH. REV. CODE ANN. § 48.22.110 *et seq*.; and West Virginia, see W. VA. CODE § 46A-3-109a).

[4] NAIC Model Laws, Regulations and Guidelines 375-1, Creditor Placed Insurance Model Act (2012).

[5] Illinois, Missouri, New Mexico, Texas, and West Virginia.

B. Dodd-Frank Act

In 2010, the Dodd-Frank Act amended the Real Estate Settlement Procedures Act to put in place federal oversight of how and when lenders can purchase lender-placed insurance. Dodd-Frank prescribes significant consumer protections that require lenders, before placing lender-placed insurance, to satisfy several requirements:

1. A lender or mortgage servicer must have a "reasonable basis" to believe the borrower's homeowners insurance coverage has lapsed before purchasing lender-placed insurance, which can only be proven if two notices of an intent to purchase lender-placed insurance are sent to the borrower 30 days apart;
2. Lenders must provide notices that:
    a. Remind the borrower of the obligation to insure.
    b. The notice must contain
        i. A statement that the servicer does not have proof of coverage;
        ii. Information concerning how the borrower can demonstrate adequate coverage; and
        iii. A statement that if the borrower does not provide proof of coverage, the servicer may purchase insurance on the borrower's behalf.
3. Borrowers must be given 45 days to provide proof of coverage before the mortgage servicer may charge the borrower for LPI;

4. "Any reasonable form of written coverage" must be accepted as evidence that the required insurance is in place;
5. Only lender-placed insurance fees that are "bona fide and reasonable" may be charged;
6. Any lender-placed insurance premiums that overlap with the borrower's own homeowners insurance must be refunded; and
7. A lender or mortgage servicer must timely respond to borrowers' requests to correct errors.[6]

These requirements become effective on January 21, 2013 unless regulations are issued and finalized before then, in which case the effective date will be prescribed by the final rule and can be no more than one year later. Most lenders already follow similar procedures, including providing adequate notice before placing lender-placed insurance, and refunding premiums paid for overlapping coverage.

C. Consumer Financial Protection Bureau Regulations

The Consumer Financial Protection Bureau (the "CFPB") intends to issue regulations in the very near future implementing the Dodd-Frank Act's requirements in connection with the CFPB's mortgage servicing rules.[7] Indeed, the CFPB has already

[6] Dodd-Frank Wall Street Reform and Customer Protection Act § 1463, 12 U.S.C. 2605 (2012).
[7] The CFPB's Semiannual Regulatory Agenda indicates that a notice of proposed rulemaking was to be filed sometime in July 2012 and that a final rule will be issued by January 21, 2013.

issued a fact sheet on its mortgage servicing rules,[8] convened a small business review panel in April 2012,[9] and begun testing model lender-placed insurance notice forms.[10] Information provided by the CFPB for the rulemaking's small business review panel indicates that the CFPB intends to propose model disclosures for lender-placed insurance that implement the requirements of the Dodd-Frank Act and to impose *additional requirements*, including:

1. "A good faith estimate of the force-placed insurance premium that the borrower may be charged;"
2. "A statement that force-placed insurance may not provide as much coverage and may cost significantly more than a hazard insurance policy purchased by the borrower;" and
3. "A statement of whether the servicer has placed or plans on force placing insurance."

These anticipated disclosure requirements from the CFPB are still subject to change: they must be proposed by the agency; the public must have an opportunity to comment on them; and a final rule must be adopted. Then mortgage servicers and lender-placed insurance providers must adapt their business practices to conform

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[8] Putting the "Service" Back in Mortgage Servicing (April 2012), *available at:* http://files.consumerfinance.gov/f/201204_cfpb_factsheet_putting-service-back-in-mortgage-servicing.pdf.

[9] Small Business Review Panel for Mortgage Servicing Rulemaking, Outline of Proposals Under Consideration and Alternatives Considered (April 9, 2012), *available at*: http://files.consumerfinance.gov/f/201204_cfpb_small-business-review-outline_mortgage-servicing-rulemaking.pdf.

[10] Bureau of Consumer Financial Protection, Submission for OMB Review; Comment Request, 76 Fed. Reg. 77766 (December 14, 2011). The ABIA submitted comments to the CFPB regarding the design and testing of its model lender-placed insurance notice forms in January 2012.

to the new requirements. The shape and scope of these additional reforms are still uncertain and will represent significant changes for lenders, mortgage servicers, lender-placed insurance providers, and consumers. The full impact of these reforms on lending is unknown. Given the uncertainty and unpredictable effects of the various reforms, the ABIA strongly recommends that any further regulatory modifications be postponed until the Dodd-Frank Act's changes are solidified, put into practice by the industry, and observed for effectiveness over a reasonable amount of time. Only then would it be prudent for state regulators to determine if *additional* changes are necessary.

III. Recent Activity of Legislatures, Regulators, and GSEs

In addition to the federal statutory and regulatory changes, several other factors are currently affecting the lender-placed insurance industry. Together, these moving pieces make the lender-placed insurance business challenging, as lender-placed insurance carriers and mortgage servicers attempt to comply with rapidly changing requirements from various regulators, legislative bodies, and attorneys general, and potential cost-control efforts by the GSEs.

A. State Attorneys General National Mortgage Servicing Settlement

In February 2012, 49 state attorneys general entered into a settlement with 5 large mortgage servicers in connection with alleged improper foreclosure practices. The consent orders issued in connection with that settlement contained several duplicative and, in some cases, additional provisions governing lender-placed insurance. For example, lender-placed insurance fees must be "commercially reasonable," rather than "bona fide and reasonable," as required under the Dodd-Frank Act; and the coverage amount must be limited to the greater of the property's replacement value, the last known amount of coverage, or the outstanding loan balance. The mortgage servicers subject to this settlement are working to implement these new requirements.

B. New York Department of Financial Services Hearings & Rate Re-Filing Requests

In May 2012, the New York Department of Financial Services (the "DFS") held three days of hearings examining lender-placed insurance issued in New York. The focus was on lender-placed insurance pricing, affiliate relationships, and commissions. The DFS indicated new regulations governing lender-placed insurance may be necessary to remedy perceived problems in the lender-placed insurance industry. In June 2012, the DFS exercised its authority over insurers doing business in New York by requiring them to submit new lender-placed insurance rate filings. This process is ongoing, and the outcome is not yet known.

C. State Legislation and Regulation

Both California and New York have proposed legislation affecting lender-placed insurance in 2012.[11] Both bills impose requirements that go beyond those outlined

[11] California Assembly Bill 1603 was introduced on February 6, 2012. It was placed in the Inactive File on May 31, 2012. New York Assembly Bill 10490 was introduced on May 29, 2012 and assigned to the Committee on Banks that day.

in the Dodd-Frank Act.

- They would apply to lender-placed hazard, flood and homeowners insurance; in comparison, the Dodd-Frank Act's provisions only apply to hazard and property (homeowners) insurance, but do not apply to flood insurance;
- They would prohibit the purchase of lender-placed insurance from affiliated entities and from entities in which the mortgage servicer has an ownership interest; and
- They would prohibit the splitting of fees in connection with lender-placed insurance.

The California bill goes further by requiring all lender-placed insurance carriers to be admitted in California.

D. National Flood Insurance Program Reauthorization

The National Flood Insurance Program reauthorization contains provisions requiring termination of lender-placed flood insurance policies following receipt of confirmation of coverage, as well as the refund of any lender-placed insurance premiums and fees during periods of overlapping coverage.[12]

[12] See HR 4348 §100244 (2012), amending 42 U.S.C. 4012a(e).

E. Changes to GSE-Required Procedures

GSEs appear to be contemplating the implementation of certain revisions to rules affecting the lender-placed insurance industry. Although such revisions are currently tentative, either because they have not been given effect, or mandatory implementation has been indefinitely postponed, it seems likely that there will be changes. These changes may address the claims processes, the cost of lender-placed insurance, compensation paid to producers and the use of excess and surplus lines carriers.

IV. Consequences of NAIC Action

As you can see, there is much going on at the state and Federal levels regarding lender-placed insurance. We appreciate the NAIC's attention to lender-placed insurance, but because of the significant amount of ongoing regulatory activity, we encourage your committees to allow the Dodd-Frank Act provisions and the regulatory rulemaking by the Consumer Financial Protection Bureau to become effective without taking further action. There is a real risk of duplication, confusion, and entanglement if the different segments of reform are not adequately considered and appropriately timed. We also hope you will encourage your member state regulators to do the same within their states and delay further regulatory actions. The CFPB's proposed changes are significant, and we are hopeful that the regulatory rulemaking process will result in a robust rule that is fair to consumers, lender-placed insurance providers, and home financing investors.

All of these elements are currently affecting both the mortgage servicing and lender-placed insurance industries. These moving pieces, often moving in different directions, complicate the necessary task of monitoring voluntary insurance and providing lender-placed insurance where required. To the extent they restrict the market, proposed changes will lessen competition and assuredly drive up the cost of credit for mortgages. We urge the NAIC to pause, at least until the CFPB's rules are finalized and implemented, before revisiting lender-placed insurance. Only at that time can the NAIC assess the current state of the lender-placed insurance industry and the extent of regulatory oversight to determine if additional action is needed.

Thank you for this opportunity to testify, and I'm glad to answer any questions you may have.