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May 28, 2013

Federal Housing Finance Agency
Office of Housing and Regulatory Policy (OHRP)
Constitution Center
400 Seventh Street SW, Ninth Floor
Washington, DC 20024

To whom it may concern:

Breckenridge Insurance Group ("Breckenridge") is submitting this document in response to Federal Housing Finance Agency (FHFA) notice number 2013-N-05, ***Lender Placed Insurance, Terms and Conditions***. While Breckenridge thanks the FHFA and its leadership team for the opportunity to contribute to this important discussion, we are also concerned that many of the recommendations listed in this response have been discussed previously and not heeded. Any further delays or partial solutions will only serve to negatively impact homeowners, taxpayers and Government Sponsored Enterprises (GSEs). It is our belief that the recommendations outlined in this document will provide the FHFA with immediate and reasonable solutions to a number of issues affecting the lender placed insurance (LPI) market.

Breckenridge recognizes the need for reform in the LPI market. We are committed to working with the FHFA and GSEs to identify changes that will benefit taxpayers, borrowers and other participants in the market.

Breckenridge supports the FHFA's proposed change number one, prohibiting *Certain Sales Commissions*. It is our belief that the current practice of some insurance providers to pay commissions to lenders or servicers that purchase LPI creates a clear conflict of interest.

This conflict exists because commission payments provide the purchasing party (servicers) an incentive to select higher cost polices to ensure maximum revenue. This puts servicers at clear odds with the end user of the insurance product — homeowners — and GSEs. This latter group, according to Fannie Mae's (FNMA) own assessment, assumes responsibility for almost 80% of the financial burden associated with LPI[1]. Although some parties have worked to voluntarily limited these types of relationships, an industry-wide solution is required.

A natural outcome of this conflict is that higher premium rates are passed on to GSEs, taxpayers and homeowners, while purchasing entities seek to earn greater income.

However, prohibiting lenders and servicers from taking commissions on LPI does not automatically incentivize current carriers to lower their rates. Rather, it simply increases the already high profit

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[1] "Lender Placed Insurance – FHFA Update." Fannie Mae. Internal company report. Sept. 28, 2012.

margins that incumbent LPI providers currently enjoy. The probability is that, unless paired with other reforms, GSEs and individual borrowers will continue to be charged rates considerably higher than a competitive market would bear.

Breckenridge additionally supports the FHFA's proposed change number two, the prohibition of *Certain Reinsurance Activities*. It is our belief that the current environment, in which lenders and servicers establish independent reinsurance companies in order to collect premiums and additional revenue on their own portfolio, creates conflicts between the priorities of private companies to ensure profitability, and the GSEs' interest in maintaining low costs.

These "captive" reinsurers have a clear benefit in creating high-cost LPI premiums. Conversely, as the organizations that shoulder the majority of costs associated with LPI, GSEs benefit from minimizing the cost and number of these types of policies. In the interests of homeowners and taxpayers, servicers must be separated from the profit derived from the placement of LPI.

We believe that these two steps will benefit the GSEs and the taxpayers who support them. Additionally, the recommendations, when implemented with other measures, will likely create pressure on the broader marketplace to improve rate environments, impacting consumers whose mortgages fall outside of the GSE's purview.

However, as stated above, while helping create a more consumer-friendly market, these steps alone will not lead to significant industry-wide cost savings or increase market pressure to reduce policy premiums.

As stated in FNMA's own "*Lender Placed Insurance — FHFA Update*[2]," the LPI market is currently restricted by a number of practices that the GSE sees as detrimental to homeowners and taxpayers alike.

These include but are not limited to:

- High costs associated with LPI coverage;
- Inability to track premiums, claims, refunds, deductibles and other information essential to monitoring rates and setting appropriate policy;
- Lack of competition — 19 of the top 20 FNMA loan servicers use one of two LPI providers;
- Tracking services bundled with insurance — which increases provider risk and makes it difficult for servicers to switch providers and achieve lower LPI rates.

Breckenridge believes that, in addition to prohibiting certain sales commissions and reinsurance activities as stated in the FHFA's notice, each of the issues highlighted by FNMA warrants attention. The most effective way to ensure that the GSEs, taxpayers and homeowners are extracting maximum value from the LPI market is to eliminate barriers to entry for well-capitalized, experienced providers of lender placed insurance.

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[2] "Lender Placed Insurance – FHFA Update." Fannie Mae. Internal company report. Sept. 28, 2012.

The FHFA and GSEs are in a unique position to welcome additional competitors into the market in a meaningful way. With two providers controlling more than 90% of all LPI premiums[3], options for consumers of LPI are severely curtailed. Public[4] and academic[5] evaluations have independently identified situations of "reverse competition[6]" in the LPI market leading directly to higher premiums, of which approximately 78% of the cost is being shouldered by GSEs[7].

Increased competition would lead to enhanced transparency as end users and objective servicers would be able to evaluate alternative coverage options and pricing packages. Armed with these data, these groups could exert pressure on providers and incumbent servicers to offer a product that is cost effective and in the best interest of the consumer.

A competitive marketplace will immediately benefit GSEs, taxpayers and those with mortgages held by GSEs. But it will also influence the broader market as well, with providers outside of the GSEs' sphere of influence likely to align premiums with the larger market. Current allegations of misalignment between premium rates and actual claim/loss ratios will be mitigated as market forces bring equilibrium to lender placed offerings.

With respect to tracking and reporting practices, Breckenridge recommends unbundling tracking services from insurance products. Currently, servicers most commonly use the tracking and reporting services of the incumbent providers. This limits the amount of data that can be collected and "makes it challenging to isolate the cost for each service and drive appropriate risk management strategies that will reduce LPI premiums[8]."

By decoupling the tracking and insurance functions, information will be more freely available throughout the market and to the GSEs, further contributing to increased transparency and allowing participants to properly benchmark actual cost vs. premium analyses.

Consideration must also be given to claims practices. Under the current model, if a servicer is receiving a commission on the LPI premium and has a stake in reinsuring the portfolio (as in the case of the aforementioned "captives"), there is an inherent disincentive to pay claims. Any claims paid would lower

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[3] Walsh, Mary Williams. "New York Investigates Insurer Payments to Banks." The New York Times. 21 May 2012. *The New York Times.* <http://www.nytimes.com/2012/05/22/business/new-york-investigates-home-insurer-payments-to-banks.html>.

[4] Lawsky, Benjamin M. "Reforming Force-placed Insurance." Letter to State Insurance Commissioners. 5 Apr. 2013. New York State Department of Financial Services. <http://www.dfs.ny.gov/about/press2013/Force-Placed_Letter.pdf>

[5] "Lender-Placed Insurance." Center for Insurance Policy Research. 7 Nov. 2012. National Association of Insurance Commissioners. 22 May 2013. <http://www.naic.org/cipr_topics/topic_lender_placed_insurance.htm>

[6] "Reverse competition" exemplified in this case by rather than competing for business by offering lower prices, insurers have created incentives for banks and mortgage servicers to buy LPI with high premiums by enabling banks and mortgage services, through complex arrangements, to share in the profits associated with the higher prices.

[7] "Lender Placed Insurance – FHFA Update." Fannie Mae. Internal company report. 28 Sept. 2012.

[8] "Optimizing Force-Placed Insurance." Pace Harmon. Client Memorandum. 27 Mar. 2013. Pace Harmon. <http://www.paceharmon.com/images/stories/white-papers/ph_advisory_27mar13.pdf>

the servicer's income on the reinsurance, which places them at odds with their responsibility to be an advocate for the borrower in pushing the LPI provider for equitable claim payouts if necessary.

Once again, simply prohibiting servicers from receiving income on reinsurance arrangements does not go far enough to solve possible conflicts with claims practices. To this point, FNMA recently forced a review of certain claims in 2012 and recovered approximately $16 million in additional payments. A proactive approach would put an objective, third-party administrator in place to ensure claims processing that is equitable to both the insured and the carrier.

In March 2012, FNMA issued a request for proposal (RFP) that sought recommendations to solve many of the issues listed above. In response to the RFP, Breckenridge identified an approach that increased competition and eliminated conflicts of interest, thereby providing cost savings directly to FNMA, taxpayers and homeowners. The proposal is scalable to Freddie Mac (FMCC), requires no changes to existing tracking relationships among the servicing community, offers multiple support alternatives to meet individual servicer needs and enables comprehensive reporting for FNMA across its entire portfolio.

In a full and open competition, FNMA selected the Breckenridge proposal over 11 separate plans, scoring it at 96% in its evaluation criteria[9] — 11 and 18 points, respectively, higher than the second and third place offerings. Breckenridge and FNMA assessed the plan to provide a projected annual savings in excess of $150 million to the GSE and to taxpayers. With the FHFA's support, Breckenridge stands ready to continue with the implementation of these cost savings.

Finally, in response to the FHFA's inquiry about "the amount of time and difficulties associated with altering contracts between contractors and Enterprise services as would result from the planned approach," Breckenridge believes that both would be minimized by the plan laid out in our proposal.

This would be achieved in a number of ways:

1. Providing servicers with the necessary resources to implement contract changes.
    a. Under the terms of our proposal, FNMA and Breckenridge would engage directly with servicers to ensure a successful rollout. Servicers would be supported throughout the implementation and armed with the information they need to ensure a smooth transition.
2. Setting a realistic timeline for implementation.
    a. The Breckenridge proposal recommends that up to 18 months be allocated to implement our suggested approach. This would allow alterations to contracts to be performed over this entire period, reducing the difficulties that may be encountered with a rapid transition. At the same time, providing this 18-month changeover period will permit many existing servicer/GSE contracts to expire, reducing the overall number that will require renegotiation.
3. Allowing servicers to retain current LPI providers if they meet improved standards.
    a. If incumbent LPI providers can meet the improved specifications laid out by FNMA, servicers will have the option to retain their services. This will reduce the total number

[9] "Lender Placed Insurance – FHFA Update." Fannie Mae. Internal company report. 28 Sept. 2012.

of contracts requiring alteration, allowing resources to be focused on GSE/servicers agreement that are being renegotiated.

4. Introducing competition to the market to encourage broad adoption of creative solutions in the LPI market.
    a. We believe incumbent providers will be incentivized to match the creativity and solution-driven motivation of new competitors, which will serve GSEs and significantly reduce any anticipated obstacles from parties to current agreements.

Breckenridge expresses its gratitude to the FHFA for its thorough and inclusive approach to this inquiry. Producing savings for taxpayers and borrowers while supporting the critical role lender placed insurance serves in well-functioning credit markets is a critical objective that must be given a high priority. Enabling market forces to drive these changes creates a sustainable solution that requires minimal regulatory monitoring once implemented.

Breckenridge believes that an LPI framework that is in large part industry-driven is the best way to effect these changes. Empowering GSEs to open the LPI market to competition — with support from objective industry partners, consumer groups and the FHFA — will limit the necessity of costly and protracted legislative procedures, while offering immediate cost savings to taxpayers and homeowners.
By allowing GSEs to lead this process and implement solutions that have already been vetted and approved, the outcomes listed above are possible with limited action required from the FHFA.

We appreciate the opportunity provided to participate in this dialogue and would welcome the opportunity to work directly with the FHFA and the GSEs on this issue in the future.

Respectfully,

Ms. Tracey Carragher
Chief Executive Officer
Breckenridge Insurance Group

FannieMae

Lender Placed Insurance (LPI) FHFA Update

September 28, 2012

FannieMae

Meeting Objective

***Request for Approval** to select Overby-Seawell (OSC) as FNM's LPI agent, communicate LPI specifications to servicers, and require servicers to meet the specifications using a provider of their choice or OSC*

- **Significant savings**
  OSC pricing yields ~$145M in annual savings to FNM and borrowers; 29% reduction from current rates
- **Financially stable program for those that participate**
  OSC has partnered with Zurich, one of the largest re-insurers in the world with significant capacity to meet Fannie Mae's LPI demand; additional potential participating carriers are contractually required to have the highest AM Best credit rating
- **Strongest RFP response**
  OSC scored the highest among the 12 RFP respondents based on an objective evaluation process that included an RFP, agreement on contract terms, and price negotiations
- **Approach addresses servicer implementation concerns**
  Provides servicers with the option to retain their current provider if they can meet FNM's specifications within a reasonable timeframe. This could reduce the burden of switching LPI providers by eliminating potential technical and operational challenges
- **Begin implementation of program**
  If approved – sign agreement, communicate with servicers, kickoff implementation

The recommended business model provides servicers with the option to retain their current provider if FNM's LPI specifications are met

LPI Current State

Fannie Mae's market scale and position as a major payer of LPI offers a unique opportunity to drive changes that will serve the best interests of Fannie Mae, homeowners, and taxpayers

- **Approximately $500M in annual LPI spend** – $390M in LPI is paid by Fannie Mae and the remainder is paid by borrowers
- **Little reporting visibility** – Fannie Mae has limited ability to track premiums, claims, refunds, deductibles and other key LPI information that are essential to monitor rates and set appropriate LPI policy
- **Two large LPI providers dominate the market** – of the top 20 Fannie Mae servicers, 13 use Assurant and 6 use QBE
- **Tracking bundled with insurance** – LPI providers bundle tracking services with LPI, increasing provider risk and making it difficult for servicers to switch providers and achieve low LPI rates
- **NY and CA Attorneys General Investigating LPI Practices** and there are pending class action lawsuits related to LPI premium pricing

Reducing LPI pricing will allow more homeowners to cure their defaults as they will be less burdened by high LPI premiums

LPI Program Approach

FNM will communicate to all servicers its price and non-price specifications, to which servicers must comply within a defined timeframe

FNM Communicates LPI Specifications to Servicers

- FNM's LPI specifications include:
  - **Pricing:** LPI pricing must be at or below FNM's negotiated pricing
  - **Reporting:** servicers must provide the required reports to enable visibility into premiums and losses to validate pricing over the long term
  - **Other non-price specifications:** LPI must comply with current FNM guidelines (e.g., coverage, deductibles)
- FNM will identify a timeframe for servicers to comply with the FNM specifications or begin to transition to OSC

Servicers Meet Specifications With Current Provider or Opt-in with OSC

- Servicers must confirm whether they will pursue their own solution or engage OSC
- Servicers must amend contracts with current providers to reflect the new specifications / terms
- Servicers must purchase LPI coverage through FNM's MGA if their current provider cannot comply with FNM's specifications

FNM Manages and Tracks Servicer Compliance to FNM's Specifications

- FNM will manage and track servicer compliance against specifications
- Reimbursements will be capped at the OSC rates
- The standard servicer monitoring processes will be followed (i.e., spot audits) to ensure servicers don't overcharge FNM or borrowers
- Non-compliant servicers will be required to transition to OSC in cases where they are not adhering to FNM's specifications

FNM is not requiring the use of any particular provider – if servicers cannot otherwise comply with FNM specifications, they must purchase LPI through FNM's MGA

Background: Overview of RFP Options

Option ❶ Select OSC as Managing General Agent

Fannie Mae & Servicers interface with one agent that manages risk across multiple carriers

- Market driven pricing using admitted lines
- Single source to FNM & Servicers for reporting & claims processing
- Multiple carriers back LPI policies
- One entity fully accountable to Fannie Mae and servicers

OSC

Operating Model 1
One Agent, Many Carriers

OSC

Carrier1 Carrier2 Carrier3 Etc...

Option ❷ Select American Modern as Carrier

Risk borne by one carrier – Fannie Mae & Servicers interface with different agents

- Carrier driven pricing
- One carrier bears and manages risk
- Multiple agents assigned to servicers – multiple sources for reporting & claims processing
- FNM deals with single entity not directly interfacing with servicers

American Modern Insurance Group

Operating Model 2
Many Agents, One Carrier

Agent1 Agent2 Agent3 Etc...

American Modern

Option ❸ Select Multiple Providers

Multiple interfaces for Fannie Mae & Servicers across different portions of the value chain

- FNM "assigns" provider to each servicer & manages risk distribution
- Servicers get different rates depending on assigned provider
- Multiple agents assigned to servicers
- FNM must actively manage and consolidate reporting from multiple entities

OSC
WNC First
QBE
American Modern Insurance Group

Operating Model 3
Many Agents, Many Carriers

OSC WNCFirst Agent3 Etc...

QBE American Modern Carrier3 Etc...

The MGA model (option 1) lowers costs, consolidates reporting information, provides a single, accountable point of contact, and maintains a competitive structure for Fannie Mae's book

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LPI Evaluation Criteria

	LPI Evaluation Criteria[1]							
	Provider	Complete RFP Response	Capacity	Tracking Solution	Signed Contract	Pricing	Final Score[3]	Recommended Provider
1	Overby-Seawell	✓	✓	✓	✓	$0.80	96%	✓
2	American Modern	✓	✓	✓	✓	$0.73	85%	
3	WNC	✓	✓	✓	✓	$0.94	78%	
4	QBE	✓	✓	✓	✓	$1.01	65%	
5	Assurant	✓	✓	✓	✗			
6	Great American	✓	✓	✗				
7	Proctor Financial	✓	✗					
8	Willis/Loanprotector[2]	✗						
9	AmWINS	✗						
10	Arthur J. Gallagher	✗						
11	Marsh	✗						
12	Finsecure	✗						

Providers evaluated at each "gate" for continued participation

[1] Evaluation criteria described in further detail in appendix B
[2] Willis did not provide pricing
[3] Final score based on quality of RFP response, cost, speed of savings, meeting strategic objectives, & innovation (see slide 5)

OSC is the recommended provider based on an objective, multi-stage provider evaluation process that included a review of RFP responses, review of other non-price factors (e.g., capacity, tracking), agreement on contract documents, and price negotiations

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Background: Scoring Methodology

Five categories were weighted to produce a bottom-line score based on an objective set of criteria

- RFP evaluators included stakeholders in credit loss severity reduction, enterprise risk management, procurement, and multifamily
- Evaluation categories were established based on conformance with requirements, cost, speed to realize savings, and provider quality
- Score above 100% means requirements were exceeded, demonstrating incremental value for Fannie Mae

Evaluation Weighting	Evaluation Category	Provider Results[1]			
		OSC	American Modern	WNC	QBE
40%	**Requirement Compliance**	107%	98%	99%	[illegible]
35%	**Cost**	$0.80	$0.73	$0.94	[illegible]
10%	**Speed to Realize Savings**	74%	44%	[illegible]	[illegible]
10%	**Strategic Objectives Alignment[2]**	4.50	1.75	4.25	[illegible]
5%	**Problem Solving / Innovation**	100%	52%	41%	[illegible]
	Total Weighted Score[3]	**96%**	**85%**	**78%**	**65%**
	Rank	1	2	3	4

= Best result

= Worst result

[1] Represents raw score prior to applying the weighting
[2] Includes ability to mitigate risk of negative headlines, increase competition, enable collaborative risk, maintain reasonable pricing, and increase pricing transparency (see slide 22)
[3] See slides 33 -35 for a description of the weightings and scoring methodology

OSC scored the highest and offers the best value proposition to FNM

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FNM Provider Recommendation

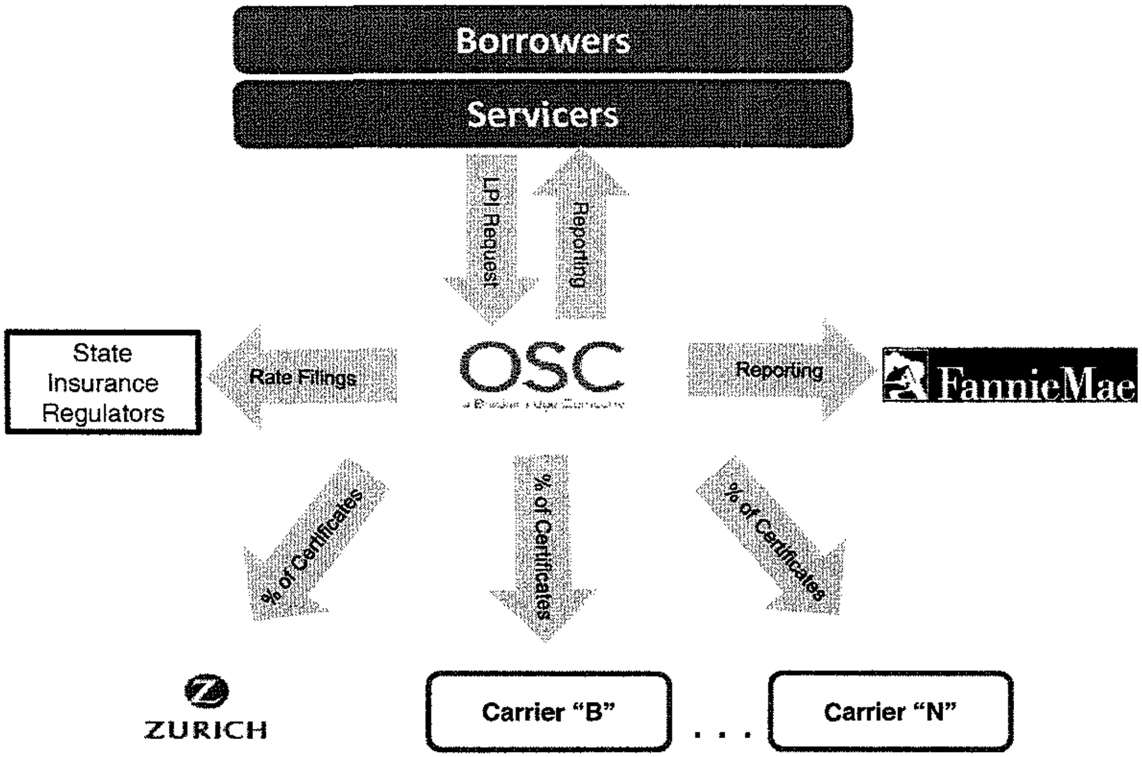
Option	Est. 1 Year Savings	Pros	Cons	Net Benefit[2]
❶ **Select OSC as Managing General Agent**	**$145M** (29%)	▲▲▲ Multiple carriers participate [1] ▲▲▲ Incumbents can participate[1] ▲▲ Preserves low price by avoiding adverse selection ▲▲ Simplified governance - one provider to manage ▲▲ Ensures market competition going forward ▲▲ Consolidated reporting ▲▲ Facilitates transition vs. one carrier option ▲ Eliminates the conflict of interest with many current "agents" ▲ Rates already filed and admitted, eliminating regulatory delays	▼▼ Reduced savings compared to lowest price provider ▼▼ Scale of FNM business will require OSC to ramp up staffing from an operating, customer service and claims processing perspective ▼ Selecting a single preferred provider concentrates risk if the provider fails to perform	+13
❷ **Select American Modern as Carrier**	**$168M** (33%)	▲▲▲ Lowest price ▲▲ Preserves low price by avoiding adverse selection ▲▲ Simplified governance – one provider to manage	▼▼▼ No opportunity for incumbents or new entrants to participate ▼▼▼ Complex implementation and program management due to multiple agents ▼▼ No competition in place to sustain low pricing ▼▼ Multiple sources for reporting & claims processing ▼ Rates need to be filed and admitted ▼ Selecting a single preferred provider concentrates risk if the provider fails to perform	-5
❸ **Select Multiple Providers**	**$111M** (22%)	▲▲▲ Multiple carriers participate ▲▲▲ QBE and other incumbents can participate ▲▲ Fastest implementation timeline for servicers currently using the recommended providers ▲ Addresses legal risk of having one provider	▼▼▼ Unfair to consumers who will pay more depending on servicer ▼▼ Highest price ▼▼ Introduces adverse selection, which could force rates up over time if providers do not receive a balanced spread of risk ▼▼ No consolidated reporting ▼▼ Complex governance	-2

[1] See slide 8 for a list OSC's carrier partners
[2] Net benefit calculated based on the total impact of pros ▲ less the total impact of cons ▼

Level of Impact ▲ or ▼ = low ▲▲ or ▼▼ = medium ▲▲▲ or ▼▼▼ = critical

The team recommends OSC as FNM's MGA – OSC provides the benefit of multiple carriers and central governance for servicers opting into the program

Structure of OSC's MGA Model



OSC Partners

Firms which OSC maintains commercial relationships that could be immediately offered to participate as carriers in the program, at OSC's discretion

- Ace USA
- AIG
- American Modern*
- Arch
- Assurant*
- AWAC
- Great American*
- Ironshore
- Lloyd's Syndicates
- Markel
- Odyssey Re
- QBE*
- Tower
- Transatlantic Re
- WR Berkley**
- XL Re
- Zurich

* Participated in Fannie Mae LPI RFP
** Invited but opted out

The OSC multi-carrier structure includes incumbents and new entrants as issuers of LPI policies

- The rates proposed by OSC have been filed and admitted in 50 states
- OSC is backed by Zurich, which could serve as a lead carrier and provide capacity to meet 100% of Fannie Mae's portfolio requirements; OSC contractually obligated to insure all risks (i.e., cannot decline to cover a property)
- OSC will request participation from incumbents and other providers at FNM's negotiated rates. Because AMIG's final pricing was lower than the rates proposed by OSC, it is likely that OSC will be able to sign up multiple carriers as risk bearers in FNM's LPI program
- Avoids adverse selection as OSC ensures that each carrier receives a risk based share of the portfolio
- Carriers could continue to provide tracking, which speeds implementation and minimizes servicer costs

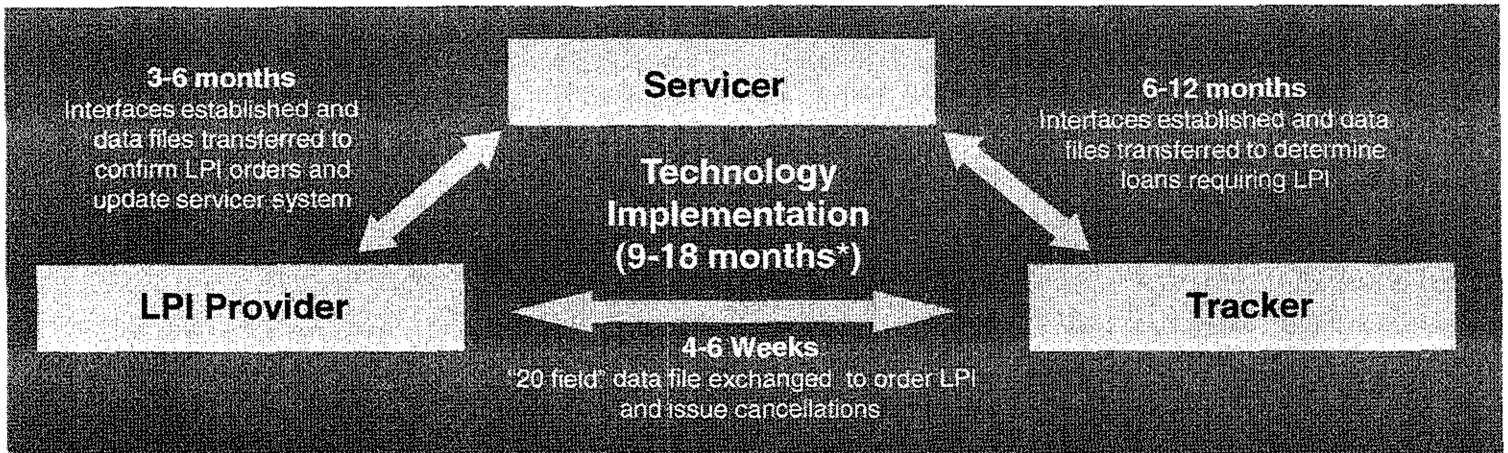
Servicer Implementation Impacts

	Servicer Requirement	Servicer Impact	Applicability[1] OSC	Current
Legal	Servicers may need to execute an agreement that complies with FNM specifications	• Current agreements will need to be modified to reflect FNM specifications • Servicer may need to conduct a sourcing process if their incumbent provider does not comply with the FNM specs and servicer does not want to use OSC without first analyzing alternatives		✓
	Servicer may need to execute a contract with OSC to provide LPI for FNM loans	• Servicer may need to terminate its existing agreement for LPI, to the extent it contains any exclusivity provisions • If FNM's contract terms (e.g., reporting, SLAs) with OSC do not meet the servicer's requirements, servicer will need to use the FNM requirements as the minimum standard and amend as necessary	✓	
Operational	Transition policies to reflect the FNM specifications	• To maximize borrower savings, in-force policies may be cancelled and rewritten under the new program. This process will require an additional borrower notification cycle	✓	✓
	Meet the requirements of the FNM communication	• Servicer will need to develop new processes to ensure FNM LPI is ordered in accordance with the LPI specs and all other FNM requirements are followed	✓	✓
	Ensure provider performs in accordance with the FNM specifications	• Servicer will own the relationship with the provider and remains responsible for day to day management of insurance and tracking	✓	✓
Technology	Integrate OSC into the servicer's tracking system	• To realize the benefits, servicer will need to incur up front IT implementation costs to integrate OSC into their current servicing platforms and processes • Servicer will need to establish the required interfaces and data transfers from its tracking solution to OSC's system • If the tracking solution is outsourced and the current tracking provider refuses to provide stand alone tracking services, servicer will need to obtain an alternative tracking solution	✓	
	Distribute to OSC a daily data file containing all loans which require LPI coverage to be added, changed or cancelled	• Servicer or their designated tracker must continue to monitor and oversee the transfer of the daily data file in the format required by OSC	✓	

[1] Applicability denotes whether the requirement and associated impact is applicable if the servicer uses OSC or their current provider

Implementation of the LPI program will impact servicers in a number of key areas. FNM plans to actively engage with servicers to ensure a successful rollout

Implementation of a New Provider



*Servicers indicated the IT implementation of both a LPI provider and tracker would not be parallel activities

- Servicers that are changing providers will be required to integrate with the new provider, a process that could take up to 18 months depending on whether the implementation entails technology integration and/or switching tracking providers
- The longer lead time appears to be more of an issue with large servicers - smaller servicers often perform their own tracking and order and cancel policies via a provider's web portal, resulting in no automated data interface requirements
- In the program implementation, Fannie Mae will need to communicate a compliance "due date" to servicers that considers this technology implementation timeframe

Large servicers have indicated the timeline for technology implementation of both LPI and tracking with two separate providers (i.e., one for insurance and another for tracking) could be 9-18 months. This is significantly longer than the 3-6 month timeline suggested by LPI providers

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Preliminary Implementation Concept

2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2

Pre-Implementation

- Complete RFP process
- Risk Committee and FHFA approve program
- Sign agreement with OSC
- Implementation planning – create transition toolkit (e.g., spec compliance forms and templates)

◆ Conduct meetings with servicers to pre-communicate program requirements and solicit early adopters

Phase 1: Early Adopters *Duration dependent on level of technology integration*

- Issue directive(s) to early adopter servicers
- Confirm ability of servicer to meet FNM specs with servicer's current LPI provider
- If specs not met, conduct solutioning sessions with early adopters and FNM agent
- Complete integration with FNM agent for ordering LPI; document lessons learned

◆ Release Guide Announcement

Phase 2: LPI Response Review

- Servicers approach current LPI provider and confirm ability to meet FNM specs
- Servicers submit response to FNM indicating (1) complying with specs or (2) working with FNM MGA
- FNM confirms specifications and operational implications
- OSC implementation schedule finalized

Phase 3: Implementation

- Servicers amend contracts to reflect FNM specs or execute agreement with OSC
- Servicers unable to meet specs integrate with OSC (may need to source and implement new tracking solution if incumbents do not provide stand alone tracking)

◆ All Servicers Compliant

Directives will be issued to voluntary early adopter participants, followed by a guide announcement whereby servicers confirm there ability to meet FNM specs

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Optimizing Force-Placed Insurance

Client Memorandum *March xx, 2013*

Introduction

The recent decision by FHFA not to move forward with Fannie Mae's proposed Force-Placed Insurance (FPI) program presents several opportunities and challenges for servicers as they consider how to manage FPI going forward.

As reported by *American Banker* on February 26, 2013 the Fannie Mae program involved the selection of an agent, OSC, who had contracted a consortium of carriers led by Zurich Insurance Group to provide FPI for Fannie Mae's portfolio. Servicers could elect to purchase FPI through this Fannie Mae-selected agent at a significantly discounted rate.

On an industry conference call, FHFA publicly announced that they are not moving forward with the Fannie Mae program. Instead, FHFA opted to gather further data and solicit broader industry participation prior to any action. FHFA has not announced a timeline for determining its recommended approach to manage FPI going forward. Considering the March 4, 2013 announcement by FHFA that Fannie Mae and Freddie Mac will build a new joint company for securitizing home loans, the approach, if any, will likely involve an industry-wide mandate for both GSEs.

While not approved by the FHFA, the Fannie Mae approach did prove that there is significant value to be unlocked by expanding provider participation in the FPI marketplace, creating transparency by decoupling insurance from tracking, and pricing each service on a standalone basis. Fannie Mae's process also created a significant amount of incremental awareness from industry stakeholders and regulators and that pressure has resulted in rate re-filings in several states. With this continued regulator focus, we expect there to be additional downward margin pressure for both FPI providers and servicers that profit from FPI. This changing environment for FPI – and the resulting impacts on the deal commercials between servicers and their FPI providers – demands that servicers gain a firm grasp of their current operations and cost structures and further consider new and innovative approaches for FPI management.

Pricing Pressure Remains an Issue

Despite the negative decision by FHFA, high FPI costs will remain an issue for servicers and the market is unlikely to revert to "business as usual".

- State regulators are putting downward pressure on pricing, as exemplified by recent requirements for re-filings from New York and Florida insurance commissions at significantly reduced rates

- Consumer groups and congressional leaders remain concerned about high FPI pricing and are pressuring banks to address perceived conflicts of interest in the FPI marketplace
- FHFA may require additional input and industry-driven solutions from servicers on how to reduce FPI costs and improve reporting and data for all stakeholders, including FHFA and the GSEs

All of this downward pricing pressure will, in turn, reduce margins for firms that profit from FPI. Given the well-documented conflicts of interest that are at times in place, it seems likely that continued focus on eliminating non value-added services will persist. However, there are other opportunities for servicers to provide value-added services that will benefit both the payer of FPI (GSEs and homeowners) as well as the companies that service their mortgages.

The competitive pressure that will drive servicers to seize these new FPI opportunities is especially relevant given FHFA's announced plan to build a new joint company for securitizing Fannie Mae and Freddie Mac home loans and eventually privatize their securitization operations. This industry-wide shift to private label MBS will change the dynamics in the FPI marketplace since the high FPI costs will be borne by banks and paid by the new loan owners (currently, approximately half of all FPI written is paid by the investor with the remainder paid by the borrower). This, in turn, will likely shift servicer focus from earning commissions for placing FPI to lowering FPI costs – and participating in the value added steps in the process. It will also put servicers in a favorable position to find new and innovative ways to manage FPI, work with new FPI partners, and potentially redesign how risk is managed.

Understanding FPI Current State

Based on these pressures, servicers should take action to prepare themselves for the new market dynamics and opportunities or risk putting themselves in a position of diminished leverage when their contracts are up for renewal.

The first step for servicers to understand and quantify these new FPI opportunities is to understand the current state. This should involve a thorough review of existing contracts as well as a benchmarking of current FPI pricing (both insurance and tracking) to understand how the servicer's current state compares to what the current market will bear.

1. Assess Current Contracts

   Servicers should evaluate their current contracts and understand the levers and limitations to amending the agreements to reflect changes to the risk being priced. Such an assessment would include, at a minimum:

   - Coverage and deductible levels
   - Term and termination
   - Exclusivity
   - Rate review
   - Data rights
   - Tracking and lettering service scope
   - Service levels

The contract assessment will help servicers understand if there is flexibility to amend current agreements, contract with additional FPI providers, re-negotiate pricing and change the scope of services (i.e., separate tracking services from FPI).

2. Benchmark Pricing

To evaluate pricing, servicers should benchmark their current rates beyond the two incumbents to better understand the appropriate premiums and tracking costs for their servicing portfolio. This will require servicers to gather data and analyze their current FPI portfolio across a number of dimensions.

FPI data should be collected by state and zip code at the policy level for all in-force policies.

- Annual premium
- Coverage amount
- Deductible
- Insurance type (hazard, flood, wind-only)

This data will enable servicers to calculate an annual premium cost per $100 of coverage across the portfolio and within each region of their portfolio, which can be used as the benchmarking baseline. The weighted average rates published by *American Banker* ranged from $0.73 - $1.01 per $100 of coverage across all geographies, although the specific rates a servicer is able to achieve will depend on their unique portfolio and the concentration of coastal versus non-coastal properties. As such, these rates are not necessarily an accurate benchmark for all portfolios.

Since tracking services can vary among providers and servicers, tracking costs will require further analysis to arrive at a market standard rate that can be used to facilitate "apples to apples" benchmarking. As a starting point for this analysis, servicers should gather the following data for the previous 12 month period.

- Average loans tracked per month
- Lettering volume per month
- Monthly print and postage costs
- Inbound and outbound call volume per month
- Total dedicated FTEs for tracking servicers
- Average hourly FTE rates
- Monthly tracking system maintenance costs

This data will enable servicers to approximate the "true" average tracking cost per loan per month, which can then be benchmarked against industry rates. Note that tracking firms may provide additional, non-tracking related services that are not included in the data or benchmark rates. Such services (e.g., market research) would need to be assessed separately.

Once the current costs are documented, servicers should seek out benchmarks, either through privately held, proprietary benchmarks or through publicly available rates in the state regulators' filings.

3. Analyze Claim and Loss Data

In addition to benchmarking current costs, servicers should analyze the risk bearing opportunity and current loss ratios on their servicing portfolio. To conduct this analysis, servicers should request historical data from their current FPI provider(s). This should include data for at least the previous three years:

- Total gross premiums paid by state and zip code
- Total claims paid by state and zip code

With this data as a starting point, servicers can conduct their own risk analysis to determine the costs and benefits of bearing a portion of the risk being underwritten. Such an analysis will also need to consider current actuarial models related to probabilities of catastrophic events.

New FPI Approaches

The lessons learned from the Fannie Mae approach can be applied to servicers who may face external pressure to reduce costs or change the way FPI is managed. Armed with contract, pricing, and loss data, servicers will be well-positioned to unlock value and optimize FPI.

1. Unbundle Insurance from Tracking

The incumbent FPI providers often price insurance and tracking as a bundled service, making it challenging to isolate the cost for each service and drive appropriate risk management strategies that will reduce FPI premiums. Since the party performing the tracking also provides the insurance, tracking costs are either not included in the contract or are included at a significantly reduced rate, since the margin is made up on the insurance. The combined service increases insurance switching costs for servicers, since the tracking is highly integrated with current servicing platforms. In addition, the combined service means that any errors in tracking that result in false placements of insurance make it easy to cancel or backdate the insurance policy as needed, further enforcing the linking of tracking with insurance.

Pricing the insurance and tracking services on a standalone basis will allow servicers to evaluate and benchmark their insurance costs and achieve appropriate pricing for the risk. There is a very competitive marketplace for FPI, but many providers are unable to compete for business with the large servicers since the incumbent's tracking services are so entwined with the servicer's business. The pricing that *American Banker* reported shows a 30% reduction in insurance premiums for the pure insurance cost – there is clearly a large opportunity for savings to be derived from pricing FPI as a standalone product.

To lower rates, servicers may elect to conduct a Request for Quote process whereby different providers compete for the FPI business. FPI requirements should be kept separate from tracking requirements and priced independently. As part of this process, servicers may elect to solicit input from various FPI providers and identify creative ways to manage risk, whereby servicers participate as risk bearers in the FPI solution.

Such savings would directly benefit large banks that operate in the private label mortgage security market, since the loan-owner pays for FPI when the homeowner is unable. As stated, the volume of private label MBS will increase dramatically with the eventual merging and winding down of Fannie Mae and Freddie Mac.

2. Get Creative About Risk Management

In addition to downward pressure on pricing, there is continued pressure in the industry to reduce or eliminate servicer commissions related to FPI placement. Since tracking firms automatically place FPI when a lapse in coverage is detected, there is little to no sales effort required on the part of servicers to earn these commissions. In fact, in the course of industry hearings held by the New York Financial Services Board in July 2012, incumbent FPI providers testified to making up-front payments to servicers to gain their business. Such payments and commissions create little incentive to lower premiums or reduce the volume of FPI placements.

To lower pricing for taxpayers and homeowners, FHFA and the GSEs will likely continue to work to eliminate such commissions and payments for non-value added services.

However, servicers that provide value added services and find creative ways to bear risk and earn commensurate returns are in a good position to benefit from some of the recent changes. Depending on a servicer's current premium cost structure, there is a potential for a "win-win", where premiums are lower and servicers are able to continue to derive FPI revenue by underwriting a certain portion of the risk themselves. This can work similar to a high deductible policy where, for example, a servicer would pay for the first $10k in losses in exchange for a portion of the written premium. The loss level can be defined in aggregate or at the loan level. The premiums collected and the level of risk assumed are based on the premium and loss history across the servicer's portfolio.

There are additional and potentially more complex arrangements that servicers can reach with their FPI and reinsurance providers to define the different tranches of risk and to price each tranche accordingly. This works similar to how securities are priced in tranches and subordinated based on the risk appetite of the investor.

Increased transparency in the industry and the wider availability of data will facilitate such risk analysis. While the pressure to reduce premiums will likely increase loss ratios to push them in line with traditional hazard insurance, there is still an opportunity for servicers that effectively evaluate the risk profile of their servicing portfolio to benefit from the insurance risk that they bear.

Conclusion

While the FHFA decision reduces short term pressure to decrease FPI premium pricing, there is likely to be continued pressure on servicers to find new and creative ways to reduce costs and change the way FPI is managed. While commissions for non-value added services will likely go away, the current environment demands new thinking on how risk is sliced and priced. With the eventual transfer of MBS volume from the GSE's to the private sector, the marketplace for FPI will change dramatically. Servicers should seize on this opportunity to gain competitive advantages in their loan servicing approach.

NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

TO: State Insurance Commissioners
FROM: Benjamin M. Lawsky
Superintendent of Financial Services
New York State Department of Financial Services
DATE: April 5, 2013
RE: Reforming Force-placed Insurance

Background

In October 2011, the New York State Department of Financial Services (DFS) launched an investigation into the force-placed insurance industry.

- Force-placed insurance is insurance taken out by a bank, lender, or mortgage servicer when a borrower does not maintain the insurance required by the terms of a mortgage.
- This occurs most frequently when a homeowner allows his or her policy to lapse, typically due to financial hardship, where the lender asserts that the homeowner does not have sufficient coverage.

Investigative Findings

In May 2012, DFS conducted public hearings – taking oral and written testimony from consumers who had been force-placed, consumer advocates, the insurance industry, and insurance experts.

DFS's investigation revealed that:

- 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 DFS 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.
- 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 one arrangement, for instance, JPMorgan Chase put itself on both sides of the transaction, paying an inflated premium and then reaping a large percentage of those gains back from Assurant, Inc., the nation's largest force-placed insurer

    - (with 70% of the market in New York), by virtue of a reinsurance agreement between a JPMorgan Chase-owned insurer and Assurant.
    - In this manner, JPMorgan Chase made approximately $600 million since 2006 by taking 75 percent of the profits from the force-placed business it sent to Assurant.

Settlement with Assurant

On March 21, 2013, DFS entered into a settlement with Assurant, the terms of which includes restitution for homeowners who were harmed; a $14 million penalty; and a set of major reforms for Assurant's force-placed insurance program in New York.

- A press release describing the terms of the settlement, and the consent order itself, are accessible at http://www.dfs.ny.gov/about/press2013/pr1303211.htm.

Specifically, the agreement requires Assurant to:

- File with DFS force-placed premium rates with a permissible loss ratio of 62 percent, supported by credible data and an actuarial analysis that is acceptable to DFS. This will substantially reduce premiums.
- Re-file its rates with DFS for review every three years thereafter.
- Re-file its rates sooner than every three years if Assurant's actual loss ratio for any preceding year dips below 40 percent.
- Report its actual loss ratio, earned premiums, itemized expenses, losses, and reserves to DFS annually.
- Make refunds to eligible homeowners who were force-placed at any time after January 1, 2008.

Further, the agreement prohibits Assurant from:

- Issuing any force-placed insurance on mortgaged property serviced by a bank or servicer affiliated with Assurant.
- Paying any commissions (including contingent compensation based on underwriting profitability or target loss ratios) to any bank or mortgage servicer (or person or entity affiliated therewith) on force-placed business.
- Reinsuring force-placed insurance policies with any person or entity affiliated with the bank or servicer that obtains the policies.
- Make any other payments to servicers, lenders, or their affiliates in connection with securing force-placed insurance business.

Subsequent Developments and Next Steps

Following DFS's resolution with Assurant, the Federal Housing Finance Agency proposed a ban on commissions on force-placed policies to banks servicing loans owned or insured by Fannie Mae and Freddie Mac.

DFS is continuing its investigation, and encouraging other force-placed insurers and mortgage servicers operating in New York to adopt the reforms to which Assurant has agreed.

Implications for Other States

The agreement reached with Assurant can serve as a template for other states to adopt. We urge other commissioners to implement these reforms nationwide to help root out the kickback culture that has pervaded the force-placed insurance industry and lower rates for hard-working homeowners. New York stands ready and willing to assist any state that is considering moving ahead with similar reforms. For further information, please contact Executive Deputy Superintendent Joy Feigenbaum, the head of DFS's Financial Frauds and Consumer Protection Division, at joy.feigenbaum@dfs.ny.gov or (212) 480-6082.