May 24, 2013

Federal Housing Finance Agency
Office of Housing and Regulatory Policy (OHRP)
Constitution Center
400 Seventh St SW, 9th Floor
Washington, DC 20024
via email LPIinput@fhfa.gov

RE: No. 2013-N-05; Lender Placed Insurance, Terms and Conditions

To Whom It May Concern:

The American Bankers Association[1] and its insurance affiliate, the American Bankers Insurance Association[2] appreciates the opportunity to comment on the Federal Housing Finance Agency's notice regarding lender-placed insurance (LPI), terms and conditions (Notice).[3] We understand that FHFA is not required to issue this notice and request for comments and appreciate that FHFA is taking this step and considering public input before proceeding.

Our comments focus on the importance and necessity of lender-placed insurance, FHFA's process and the impact of FHFA's proposal.

I. Importance 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 and Freddie Mac (collectively the GSEs), require borrowers to maintain homeowners insurance and flood insurance (if applicable). Insurance protects the borrower's home, which the borrower, lender and investor use as collateral for the mortgage, by providing funds to repair or rebuild the home following a loss. Lenders and investors require mortgage servicers to track the status of each borrower's insurance coverage and notify borrowers when the tracking process indicates the borrower's insurance policy has terminated.

If a borrower fails to maintain the required insurance, lenders and investors are exposed to a significant risk of loss. To mitigate that risk, lenders and investors typically require borrowers to advance funds for the required hazard or flood policy, which are paid along with the monthly mortgage payment and placed in an escrow account maintained by their mortgage servicer. If escrowed funds are not available, mortgage servicers will, in some cases, advance their own funds

[1] ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.
[2] The American Bankers Insurance Association is a subsidiary of the American Bankers Association and 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.
[3] Lender Placed Insurance, Terms and Conditions, 78 Fed. Reg. 19263 (Mar. 29, 2013).

to pay the premium for voluntary insurance. Under the Consumer Financial Protection Bureau's (Bureau) new mortgage servicing rule, effective January 2014, if a borrower has escrowed for insurance but the escrowed funds are depleted, the servicer is required to advance funds to pay the premium for the voluntary hazard insurance, unless the insurance was cancelled for reasons other than nonpayment or the property is vacant.

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 residential properties, 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.

Lender-placed insurance is a last resort used to protect the investor's collateral. Without this insurance of last resort, lenders and investors' costs would rise significantly due to uninsured losses. The rise in defaults and foreclosures since the housing crisis began in 2008 has resulted in more borrowers' voluntary insurance lapsing and increased the need for lender-placed insurance. However, even in this difficult economy, most borrowers maintain property insurance as required by the mortgage, which means that, for most mortgage servicers, only about two percent of all mortgages have activated lender-placed insurance.[4] That percentage will likely decrease as the housing market recovers. Of the small number of LPI coverages, only part of the costs are passed along to the investors, including the GSEs, as the borrower is responsible for reimbursing the servicer, and the investor only reimburses if the borrower is in foreclosure and is unable to pay.

In addition to reimbursing for LPI when the collateral is in foreclosure, investors, including the GSEs, regularly reimburse servicers for advancements to cover voluntary hazard insurance, private mortgage insurance, and tax disbursements.

LPI serves an important purpose of ensuring preservation of home values. During times of widespread economic distress, it becomes especially critical to protect borrowers by ensuring there will be sufficient funds to repair their home in the event of a loss, maintaining the value of the collateral, and preserving the solvency of housing lenders and investors.

II. Comments on FHFA's Process

We understand this Notice is just one part of broader reforms the FHFA is planning, and we believe a better approach is a more comprehensive understanding of all of the reforms.

The Notice states that "while FHFA plans a broader review of issues relating to the market for lender-placed insurance, that includes receiving input from government and private sector

[4] This figure is based on testimony submitted before the New York's Department of Financial Services for hearings on lender-placed insurance, available at http://www.dfs.ny.gov/insurance/hearing/fp_052012_testimony.htm (May 10-12, 2012).

parties, the practices that are addressed here are considered sufficiently distinct as to merit early action" by FHFA.[5] It is difficult to ascertain whether these practices are different because there is no detail on what other LPI practices the FHFA is reviewing. While we appreciate the opportunity for input on the action the FHFA is taking, a holistic view of other actions the FHFA is considering regarding LPI would result in a better process and outcome. The FHFA should not move forward with this proposal until it has engaged in a complete review of, and provided an opportunity for comment on, all aspects of LPI.

Additionally, the FHFA has been considering changes to mortgage servicing compensation. In 2011, the FHFA released a discussion paper on alternative mortgage servicing compensation with a request for public comments. Since that time, FHFA has not taken any additional public action on the proposal; however in FHFA's Strategic Plan for Fiscal Years 2013-2017, FHFA indicated that it will continue this initiative to address "servicer compensation and how it affects servicer's performance and their allocation of resources."[6] Given that this Notice is directly related to servicer compensation, LPI should be part of that overall process, and any changes made to servicing compensation structure should be made in a cohesive way that considers the processes and costs involved in running an LPI program. Moreover, servicing compensation will be an important factor as the Congress and Administration consider the future of the housing finance system in the United States, particularly the government's appropriate role in such a system. Absent a compelling and immediate need, we strongly encourage the FHFA to defer any further action to alter servicing compensation, including the role of LPI, until it can be addressed as part of a holistic reconsideration of the entire mortgage finance system.

III. Comments on Substance of Notice

FHFA's Notice seeks to "prohibit sellers and servicers from receiving, directly or indirectly, remuneration associated with [1] placing coverage with or maintain placement with particular insurance providers" [and 2] an insurance provider ceding premiums to a reinsurer that is owned by, affiliated with or controlled by the sellers or servicer."[7] As explained in more detail below, this prohibition on compensation for services actually performed could subvert the FHFA's objective of reducing its costs and should be abandoned.

a. Basis for Commissions and Reinsurance Arrangements

Sellers and servicers use licensed insurance agencies to purchase LPI policies because of their expertise and experience in finding insurers with ideal policies and for the host of services they provide in managing an LPI program. Agencies negotiate and administer the contractual arrangements between sellers or servicers and insurers. They also handle LPI management and administrative matters, including claims administration, customer service, complaint management, insurer auditing and quality control, premium handling, including advancing bank funds when necessary, and policy cancellations.

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[5] 78 Fed. Reg. at 19263.
[6] Federal Housing Finance Agency, Strategic Plan Fiscal Years 2013-2017 (available at www.fhfa.gov/webfiles/24576/FinalFHFAStrategicPlan10912F.pdf).
[7] 78 Fed. Reg. at 19264.

Reinsurance arrangements involve the shifting of risk from an LPI insurer to an unrelated reinsurance company, reducing direct risk for the LPI carrier and freeing capital to issue more LPI policies. Reinsurance transactions represent an actual risk transfer, based on actuarially determined loss ratios and premiums that are approved by domiciliary states, and reinsurers are contractually bound to pay losses. Reinsurance contracts are required to pass risk transfer guidelines based on generally accepted accounting principles (GAAP) as outlined in FAS 113. Also, captive insurers must file audited financial statements and are regulated by state captive insurance departments.

The FHFA's proposed prohibition of compensation in connection with LPI agency activities and certain reinsurance arrangements fails to recognize the cost of, and value added by, the functions performed.

b. The Proposal Will Not Limit the FHFA's Potential Losses, but Will Merely Shift Costs from Defaulting Borrowers to All Borrowers

Eliminating agency commissions and affiliate reinsurance arrangements will merely shift LPI related costs from the borrowers that fail to maintain adequate insurance to all borrowers in a servicer's or seller's entire portfolio. Servicers and sellers that are required to perform the activities of agencies will likely experience increased costs, since they will be performed in-house and without the efficiencies an agency can provide. Moreover, the cost of LPI policies offered by underwriters will likely increase since underwriters will have a limited ability to purchase reinsurance for LPI policies and decreased capital available for the issuance of new policies. Servicers and sellers facing increased LPI administrative costs and premiums will be required to increase the fees they charge lenders and investors, including the GSEs, to service entire portfolios of loans. In effect, the costs imposed by borrowers who fail to obtain required insurance would be spread to all borrowers, which is unfair and unwarranted.

c. Commissions and Reinsurance Arrangements are Subject to State Regulation

LPI commissions and reinsurance arrangements are subject to sufficient state regulation. Commissions are an integral part of an insurer's rate filings and are approved by the states. The FHFA recognizes in its proposal that "some states already have required or have considered rate reductions of 30 percent or more."[8] The states are aware that some insurers' LPI rates need to be adjusted and some states have requested revised rates, as they deem appropriate. State insurance regulators are in the best position to determine LPI and reinsurance rates, including commissions, and the FHFA's proposal represents an unwarranted usurpation of state insurance powers.

d. FHFA's Potential Losses Will Decrease With the Housing Recovery and Implementation of the CFPB's Mortgage Servicing Rules

The rise in LPI was a direct result of the housing crisis, which triggered a significant number of defaults and foreclosures. The housing market is slowly returning to a normal state and the number of defaults and foreclosures is decreasing. As the housing market and the economy in general improves, the incidences and impact of LPI will decrease.

[8] 78 Fed. Reg. at 19263.

e. Reasonable Alternatives

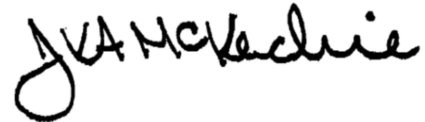
The FHFA states that LPI is commonly purchased "due to lapse of voluntary insurance coverage for non-payment of premium."[9] However, as mentioned above, the Bureau's recently promulgated rules require servicers to advance funds for escrowed homeowner's insurance premiums when a lapse occurs due to non-payment of premium, which will largely offset this concern. Those rules become effective in January 2014 and should be given a chance to impact the LPI market before further actions are taken.

In the event the FHFA proceeds with the Notice's policies, we ask that any changes be prospective and not retroactive because current servicing contracts consider compensation for these activities in their overall pricing. This is another reason that LPI should be considered in connection with the FHFA's mortgage servicer compensation policies.

IV. Conclusion

Again, we thank the FHFA for the opportunity to comment on this Notice and we look forward to working with FHFA staff on this issue in the future. If you have any questions or need additional information, please contact the Robert Davis at 202-663-5588 or RDavis@aba.com; or Kevin McKechnie at 202-663-5172 or Kmckechn@aba.com.

Sincerely,



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[9] 78 Fed. Reg. at 19263.