NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

May 28, 2013

Via Email to Comment Portal

Mr. Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
OHRP, Constitution Center
400 Seventh Street SW., Ninth Floor
Washington, DC 20024

Re: FHFA No. 2013-N-05: Lender Placed Insurance, Terms and Conditions

Dear Mr. DeMarco,

The New York State Department of Financial Services ("DFS") is pleased to submit this letter to the Federal Housing Finance Agency ("FHFA") in response to FHFA's request for comments on appropriate action with respect to lender-placed insurance, which is also known as force-placed insurance. DFS has been investigating the force-placed insurance industry since 2011 and recently reached settlements with Assurant, QBE and Balboa, which together represent more than 90% of the force-placed insurance market in New York. DFS expects to shortly conclude agreements with all remaining admitted insurers writing force-placed insurance in New York. FHFA's March 29 Notice includes prohibitions that correspond to key prohibitions in DFS's settlements. DFS strongly supports FHFA's effort to apply these prohibitions nationally to Fannie Mae and Freddie Mac (the "Enterprises") guaranteed loans.

DFS launched an investigation of the force-placed insurance industry in October 2011. 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 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. In the event of foreclosure, the costs are passed onto investors, and when the mortgage is owned or backed by the Enterprises, those costs are ultimately borne by taxpayers.

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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 servicers, through complex arrangements, to share in the profits associated with the higher prices.

Commissions and other Compensation to Mortgage Servicers and their Affiliates

DFS's investigation revealed that many lenders and/or mortgage servicers have affiliated insurance agencies or brokers that receive commissions from force-placed insurers for services the agencies or brokers purportedly provide. The evidence from DFS's investigation indicates that the affiliated agencies and brokers do little or no work for the commissions force-placed insurers pay them. Force-placed insurers do much of the work associated with force-placed insurance, including tracking insurance coverage and communicating with homeowners.

Force-placed insurers also pay some mortgage servicers what are characterized as expense reimbursements related to force-placed insurance. These payments are typically a percentage of the amount of premium force placed on the servicer's portfolio and appear to be substitutes for commissions; force-placed insurers typically pay the expense reimbursements only to servicers that do not have affiliated insurance agencies or brokers.

Commissions and other compensation paid to affiliates of servicers is a form of reverse competition; when insurers compete for servicers' business by offering higher commissions to servicers' affiliates, there is no incentive to reduce force-placed insurance premium rates. Rather, there is an incentive for mortgage servicers to purchase higher priced force-placed insurance and for mortgage servicers to place more homeowners into force-placed insurance, because their affiliates earn more commission as premiums increase.

DFS's recent settlements with Assurant, QBE and Balboa prohibit such commissions and other compensation. DFS strongly encourages FHFA to adopt the restriction in its March 29 notice that would prohibit servicers from receiving, directly or indirectly, remuneration associated with placing coverage with or maintaining placement with particular insurance providers.

Reinsurance Arrangements with Servicers' Captive Reinsurers

DFS's investigation also revealed that force-placed insurers have entered into quota share reinsurance arrangements with mortgage servicers' captive reinsurers under which the captive reinsurer receives a percentage of the premium and assumes the same percentage of the risk.

Because of the low loss ratios for force-placed hazard insurance, such reinsurance arrangements have been highly profitable for servicers.

These reinsurance agreements incentivize higher premium rates. Force-placed insurers receive a ceding fee (typically a percentage of the premium ceded to the reinsurer) as a part of the reinsurance transaction; the higher the premium rate, the more the force-placed insurer receives as a ceding fee. The arrangements also create conflicts of interest for servicers. While servicers maintain that they are interested in ensuring that their homeowner customers' claims are properly handled, the reinsurance arrangements create an incentive for servicers to refrain from submitting claims and to delay or inhibit the claims process, because their affiliated reinsurers earn more when claims are not paid.

DFS's recent settlements with Assurant, QBE and Balboa prohibit such reinsurance arrangements. DFS strongly encourages FHFA to adopt the restriction in its March 29 notice that would prohibit servicers from receiving, directly or indirectly, remuneration associated with an insurance provider ceding premiums to a reinsurer that is owned by, affiliated with or controlled by the servicer.

Conclusion

DFS appreciates the efforts of FHFA to extend these important protections to all Enterprise loans. We urge FHFA to implement these reforms nationwide to help root out the kickback culture that has pervaded the force-placed insurance industry. In addition, the agreements DFS has reached with Assurant, QBE and Balboa can serve as a template for other states to adopt. New York stands ready and willing to assist any state that is considering moving ahead with similar reforms.

Sincerely,

Benjamin M. Lawsky
Superintendent of Financial Services