May 28, 2013

Federal Housing Finance Agency
OHRP
Constitution Center
400 7th Street, SW
Ninth Floor
Washington, DC 20024

Dear Sir or Madam:

The Mortgage Bankers Association (MBA) appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA) notice of its intent to instruct Fannie Mae and Freddie Mac (the GSEs or Enterprises) to prohibit certain activities with regard to lender-placed insurance (LPI).

LPI is a necessary tool in ensuring safe and sound consumer mortgage markets. Property insurance protects the interests of both the homeowner and the mortgage investor. Borrowers and investors benefit from LPI in the event of damage or loss of the property. This was clearly evident in both Hurricane Katrina and Super Storm Sandy. Without such insurance, some borrowers would have lost their largest investment. We understand and support FHFA's efforts to limit the GSEs' unnecessary operating costs. LPI presents several complicated issues that need to be carefully considered before they are revised. We are, therefore, pleased that FHFA plans a broader view of LPI issues. We appreciate FHFA's practice of seeking public input as it addresses the many LPI complexities.

This letter notes some areas where the proposal would benefit from additional consideration of servicer compensation matters regarding commissions, affiliate relationships, and reinsurance.

1. <u>In General</u>

FHFA expresses concern that LPI loss ratios are significantly below those for voluntary hazard insurance and thus do not support the current premiums. The FHFA does recognize that states have begun requiring LPI rate reductions. LPI premiums, as insurance generally, is state-regulated rather than federally regulated. We believe that FHFA should continue to defer to the authority given by the McCarran-Ferguson Act to each state's department of insurance to regulate insurance costs. We are concerned the FHFA, by implementing these prohibitions, would effectively be acting as a federal regulator of insurance.

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FHFA expresses concern that LPI costs to the GSEs have increased in the wake of the financial crisis. FHFA states that some have raised concerns about LPI commissions and compensation. In order to keep the GSEs' LPI costs as low as possible, FHFA proposes to require:

> "1. Certain Sales Commissions. The Enterprises shall prohibit sellers and servicers from receiving, directly or indirectly, remuneration associated with placing coverage with or maintaining placement with particular insurance providers.
>
> 2. Certain Reinsurance Activities. The Enterprises shall prohibit sellers and 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 sellers or servicer."

2. <u>Accurate Cost Assessment is Appropriate</u>

FHFA takes the position that the GSEs' costs are too high, but it appears to consider total costs only, without tying the reasons for the costs to the practices the proposal would prohibit. There are several reasons for high costs that are unrelated to the reinsurance, affiliation, or commissions the proposal would prohibit. For example, in the wake of the financial crisis, the average life of an LPI policy has lengthened, which has increased the total cost. Some states have exceedingly long foreclosure timelines, and properties waiting for foreclosure have LPI in place for an extended period for this reason. Similarly, in disaster areas, properties may sit vacant for extended periods, again, with LPI in place. Looking at total LPI costs for the GSEs, or even for one of the GSEs, will mask the underlying reasons for the costs.

It is unclear whether FHFA and the GSEs have researched the impact of catastrophic events on the rates for insurance. However, we are concerned that recent articles on loss ratios appear to perform a "point-in-time" analysis, when LPI production has increased at the same time there has been a general lack of serious catastrophic losses in LPI. This is problematic. Such analyses exclude major events, such as Hurricane Katrina, which are the most costly and drive up loss ratios and premiums, rather than other factors such as commission structures. A position that servicers must now bear some of the costs that are otherwise part of standard insurance premiums deserves a more in-depth conversation about appropriate loss calculations for servicer and affiliate compensation in performing LPI management.

3. <u>Commissions</u>

The notice states that several parties have raised concerns about commissions, and the proposal would prohibit LPI commissions to sellers and servicers in all circumstances. This prohibition is overbroad.

Based on the plain reading of the notice, the FHFA appears to accept the practice of paying commissions if they are paid to a non-affiliate, but not if they are paid to an affiliate of the servicer. This policy discriminates against servicers who have lawful insurance agencies or brokerage affiliates and who bear the cost and responsibility for obtaining the insurance and other services of value. Instead of instituting a general prohibition on commissions to servicers and their affiliated insurance agencies, we ask that FHFA consider the development of appropriate standards the affiliated agency must meet in order to earn such commission. These standards would ensure that bona fide agency services are being provided, and that the cost of

the insurance is reasonable and customary in comparison to similar services provided by unaffiliated third parties.

Some have raised concerns that commissions between affiliates can present conflicts of interest. We do not believe this is an issue. LPI is borrower-driven. Borrowers are responsible for maintaining insurance. Before any LPI takes effect, borrowers are notified at least twice, with plenty of time to act. They are specifically notified that LPI may cost more and may provide less coverage than voluntary insurance. Servicers do not elect when LPI is required and cannot place insurance unless the borrower has failed to secure coverage as required by the mortgage. Moreover, when a borrower has or obtains voluntary coverage, the servicer is required to refund the cost of overlapping coverage, including the commission. Since LPI premiums are only charged when borrowers fail to maintain the hazard or flood insurance pursuant to the terms of the mortgage loan, the cost of maintaining the LPI program is borne by the borrowers who use it.

We understand FHFA's desire to keep lender-placed insurance costs to the Enterprises reasonable, but we believe FHFA should defer to the authority given to each state's department of insurance to regulate insurance costs, many of which have been and are reviewing LPI premium rates and seeking adjustments. Significantly, we are not aware of any state, as part of their rate review process, promulgating any rules that would prohibit the payment of commissions to licensed affiliates of servicers.

Finally, while the entire purpose of the proposal is to limit the GSEs' costs, the proposal would extend beyond this objective to prohibit commissions that do not result in costs to the GSEs. An absolute bar on commissions may significantly impact the viability of LPI management overall.

4. Reinsurance Transfers Risk

The proposal would prohibit remuneration to a servicer when an insurer cedes premiums to an affiliated reinsurer. Reinsurance actually transfers risk from one party to another. For that very reason, it is a valid risk management tool. Any party bearing risk requires remuneration.

As drafted, the proposal would also prohibit direct or indirect:

> "remuneration associated with an insurance provider ceding premiums to a reinsurer that is owned by, affiliated with or controlled by the sellers or servicer."

A servicer that is affiliated with a reinsurer may indirectly receive remuneration from a reinsurer based solely on the fact of the affiliation, as affiliates may share in the profits of each other. The servicer may receive indirect remuneration even when the servicer does not service the loan in question. This should have no bearing on the GSEs, and should be outside the scope of any FHFA prohibition.

FHFA has not demonstrated that the fact of affiliation with a reinsurer increases the GSEs' costs. As drafted, the proposal would require affiliated servicers and reinsurers to divest one of their businesses. This would be a disproportionately drastic step.

If FHFA's concern is that reinsurance with an affiliate involves inappropriate prices, it should focus its prohibition on the practices at issue rather than banning reinsurance more broadly.

5. Effective Date Should Accommodate Existing Contracts

We note a concern about an implementation period for any final prohibition. An existing reinsurance program cannot be immediately stopped. For example, an LPI policy with a one-year term, and a one-year reinsurance contract, that is effective on June 1, 2013 will need to remain reinsured through June 1, 2014. The state that regulates the reinsurance program may not allow a mid-term cancellation of a reinsurance policy. We recommend that any final prohibition or guidance not require unwinding existing contracts and not require noncompliance with state law.

6. Conclusion

The MBA is pleased that FHFA is carefully considering a number of complex matters as it seeks to prevent unnecessary costs to the GSEs and taxpayers. We, therefore, appreciate the opportunity to comment. Our members have diverse views on the issues outlined in this notice. We, therefore, believe further dialogue on these issues is appropriate, including a discussion of appropriate affiliation and FHFA's broader agenda with regard to lender-placed insurance. We would like to meet with FHFA staff in the near future, before the policies outlined in the notice are finalized. Please feel free to contact Pete Mills, (202) 557-2878 for further information.

Sincerely,

Pete Mills
Senior Vice President of Residential Policy and Member Services
Mortgage Bankers Association