**Supplement Comments of the Center for Economic Justice**
**In Opposition to Approval of American Security Insurance Company**
**Florida Lender-Placed Insurance Rate Filing, OIR # 13-04125**

**July 15, 2013**

On July 12, 2013, ASIC sent a response to the following question from OIR regarding ASIC's "sample monthly insurance tracking waterfall" presented at the FHFA LPI meeting in June 2013:

> Provide for each box relative to American Security and its servicers total time and dollars spend on each activity split between bank mortgage and insurance function and separately document how much is included in rate filing indications for any expense category Commissions, Other Acquisition or General Expense."

ASIC's response fails to answer OIR's question. Instead, ASIC argues that expenses associated with insurance tracking activities should be included in LPI rates. This argument is incorrect and, if accepted, would allow LPI insurers to include kickbacks to mortgage servicers in LPI rates with the result that mortgage servicers will charge unreasonable and excessive amounts to borrowers for LPI and claim, falsely, that the charges to borrowers were approved by state insurance regulators.

ASIC's July 12, 2013 non-substantive response underscores the requirement for OIR to disapprove the proposed filing and to take action to disapprove the current rates of ASIC.

**ASIC's argument that insurance tracking is part of the insurance function – "supporting risk and exposure management" – is illogical and demonstrably incorrect.**

Insurance tracking is a function of and the responsibility of the mortgage servicer. This fact is admitted by ASIC in its March 1, 2013 cover letter to the filing:

> Any type of real estate loan involving a commercial or residential structure requires the borrower to keep sufficient insurance coverage in force to satisfy the lender's interest should the structure (collateral) be destroyed or damaged. In order to make sure this requirement is met, **most lenders have a department which keeps track of all the insurance policies covering properties for outstanding loans.** If borrower provided coverage is cancelled or expired, **the lender begins sending a series of follow-up letters** to the borrower reminding the borrower of his obligation to keep insurance in force. **If the borrower fails to comply, the lender will request issuance of the policy.**

This description, unlike that of the July 12, 2013 ASIC response, is consistent with regulatory requirements of servicers as well as contractual requirements of servicers by mortgage owners. The mortgage servicing rule promulgated by the Consumer Financial Protection Bureau in January 2013 sets out specific requirements of **servicers** regarding notification to borrowers prior to the servicer charging for LPI, among other requirements of the servicer. The CFPB's rule clearly contemplates that insurance tracking is the responsibility of the servicer. Consequently, expenses associated with insurance tracking are the responsibility of the servicer.

The fact that insurance tracking is not an expense properly included in LPI rates is further demonstrated by the Fannie Mae Request for Proposal for Insurance Tracking and LPI servicers. Fannie not only identified insurance tracking as a separate activity from provision of LPI, but specifically identified the issue that including tracking expenses in LPI rates caused mortgage owners to pay servicers twice for insurance tracking – once in the service fee mortgage owners pay to servicers and second in inflated LPI rates when mortgage owners are forced to pay for LPI when a borrower defaults. The Fannie RFP from March 2013 states:

> After extensive internal review, Fannie Mae believes that current Lender Placed Insurance costs are not market competitive and can be improved through unit price reductions and fee transparency to the benefit of both the taxpayers and homeowners.
>
> Current Situation
> Fannie Mae's current Lender Placed Insurance situation is as follows:
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> 1. Homeowners are required to maintain voluntary hazard insurance on Fannie Mae insured properties.
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> 2. Lender Placed Insurance must be acquired by mortgage Servicers when a property is no longer eligible for Voluntary Insurance, or when the Servicer cannot obtain proof of adequate Voluntary Insurance from the homeowner, irrespective of whether or not that homeowner is current or delinquent on the loan.
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> 3. The cost of Lender Placed Insurance is higher than the cost of voluntary hazard insurance. Homeowners are billed for the Lender Placed Insurance premiums. However, if the homeowner does not pay the premium (for example, if the property has already been vacated), then Servicers pass on the premium costs to Fannie Mae.
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> 4. Servicers are responsible for providing tracking services, per Fannie Mae Guidelines. Many large Servicers have chosen to outsource the Insurance Tracking and associated administrative process to third parties, the largest of which are affiliated with Lender Placed Insurers.
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> 5. Lender Placed Insurers often pay commissions/fees to Servicers for placing business with them. The cost of such commissions/fees is recovered in part or in whole by the Lender Placed Insurer from the premiums, which the Servicers pass on to Fannie Mae.

6. The existing system may encourage Servicers to purchase Lender Placed Insurance from Providers that pay high commissions/fees to the Servicers and provide tracking, rather than those that offer the best pricing and terms to Fannie Mae. Thus, the Lender Placed Insurers and Servicers have little incentive to hold premium costs down. In addition, Fannie Mae is often paying twice for Insurance Tracking services; once via the servicing fee that Fannie Mae pays to Servicers, and again via the Lender Placed Insurance premiums, since those premiums may include or subsidize the costs of tracking services (to the extent that insurers are providing such services).

In appropriate Circumstances, Lender Placed Insurance is necessary and important to the preservation of Fannie Mae assets. However, much of the current Lender Placed Insurance cost borne by Fannie Mae results from an incentive arrangement between Lender Placed Insurers and Servicers that disadvantages Fannie Mae and the homeowner.

***"Supporting Risk and Exposure Management"***

ASIC's argument that insurance tracking – "the entire process is part of the insurance function" – is necessary to support "risk and exposure management aims" is incorrect and contradicts both the statement by ASIC in its March 1, 2013 cover letter, cited above, and statements in response to OIR questions that "non-insurance expenses have already been removed from the filing"[1] by ASIC.

It is clear that insurance tracking is not equivalent to the "determination of adequate capital, purchase of reinsurance . . . are predicated on the ability to accurately identify and monitor exposures" as claimed by ASIC. While a sound insurance tracking practice by the servicer is important for the LPI insurer, that fact does not equate to insurance tracking being an expense properly included in LPI rates. Insurance tracking is not necessary for the determination of adequate capital and the purchase of reinsurance. This fact is borne out by the following:

***LPI is underwritten and priced, through schedule rating, at the servicer portfolio level.*** An LPI insurer like Assurant is able to underwrite and price at the portfolio level because characteristics of the loan portfolio reveal to Assurant the likelihood and location of LPI placements. If Assurant or other LPI insurers were not able to underwrite based on portfolio characteristics – as opposed to actual numbers of LPI policies in place – the LPI insurers would never be able to write a new master policy.

[1] Page 2 of ASIC July 12, 2013 response to OIR

**Current LPI coverages in force are not necessarily a guide to future LPI placements.** LPI placements – LPI coverages in-force – can vary dramatically over a 12-month period. If ASIC or other LPI insurers relied upon LPI coverages in force for capital and reinsurance determinations, the LPI insurers would have had to stop writing LPI insurance in 2007 when LPI exposures increased by 50% from 2006 or would have had to stop writing LPI again in 2008 when LPI exposures increased by 33% from 2007. Needless to say, ASIC and other LPI insurers wrote the additional business.

In addition, LPI placements are affected by broader economic conditions and Assurant is aware of this, as noted below. Changing economic conditions in the country or in particular regions, including the unemployment rate, and changing procedures for foreclosure significantly impact the LPI placement rates. These factors are clearly more important for projecting capital and reinsurance needs than current coverages in-force.

**ASIC's LPI exposures have grown significantly when existing servicer clients acquired additional servicing portfolios.** In a conference call with investment analysts discussing results for first quarter 2013, Assurant CEO Robert Pollack stated,

> "We now provide insurance and related services for nearly 33 million loans, This represents a 16% increase from first quarter of last year, even though we believe the nationwide inventory of mortgage loans declined over that period. Our strategy of aligning with market leaders continues to pay off. In the next 2 quarters, we will add another 900,000 loans from portfolio acquisitions of 2 our our clients."[2]
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> In that conference call, Assurant CFP Michael John Peninger stated,
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> "We onboarded 1.7 million loans in the first quarter. And, as Rob mentioned, we expect to add another 900,000 loans over the next two quarters. These 2.6 million new loans will produce premiums starting later this year. The changing composition of our loan portfolio, combined with macro trends will lead to lower placement rates in the future; however the new loans will help sustain our revenues over the course of 2013."[3]
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> Later in the call, Peninger and Pollock stated the following:[4]
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> **Michael John Peninger**
> "Well, there's a lot of expenses associated with onboarding the loan, Sean, and we've got a couple of things going on, just adding the loans, getting them onto the system, and then you've got - going forward, you've got the service requirement for those. And we're certainly committed to maintaining the highest levels of service that we've had in the past, so that requires a certain amount of staff to do that. We have a very sophisticated system that helps us in this. So there's - they're not all purely variable cost, but there are

[2] Assurant Earnings Call Transcript 2013 First Quarter, attached, at pages 2 - 3
[3] Assurant Earnings Call Transcript 2013 First Quarter, attached, at page 4.
[4] Assurant Earnings Call Transcript 2013 Frist Quarter, attached, at page 10

certainly some of those, and we want to be sure that we're maintaining our customer service levels."

**Robert B. Pollock**
"And some of those expenses come before the premium shows up. And that's always been how this business has worked and I think will continue to. So these portfolio additions are not coming from existing clients, which is a little bit different than if they come from someone we have already. There's expenses if we lose from one of our clients but it goes to another. We know all the processes, procedures. We know something about the loans. When they come from a portfolio we don' have, there's more work involved."

***Assurant's Reinsurance Program Clearly Does Not Depend on Insurance Tracking***

The attached article, reflecting an Assurant press release, describes Assurant's 2013 property casualty reinsurance program. The release states that the 2013 catastrophe reinsurance program includes newly issued three-year catastrophe bonds. A reliance on three-year catastrophe bonds cannot be based on current in-force exposures, but must be based on projections of in-force exposures over a three-year period in which the actual in-force LPI exposures will vary dramatically as borrowers either obtain voluntary insurance or have their homes foreclosed.

In summary, while it is important for an LPI insurer to insist that a mortgage servicer have an effective insurance tracking program in place to ensure the LPI insurer is receiving premium for coverages provided, insurance tracking expenses are not necessary for "risk and exposure management" and must be excluded from LPI rates. The quotes from Peninger and Pollock indicate that Assurant, in fact, evaluates risk and exposure at the portfolio level and that "macro" factors play a critical role in evaluating risk and exposure on a going-forward basis.

The earnings call transcript quotes also show that, even though Assurant incurs significant expenses for various hazard outsourcing services provided to servicers like boarding new loans and insurance tracking, Assurant considers these expenses associated with LPI premium revenues. It is essential for insurance regulators to break that linkage in terms of LPI rates. While it is reasonable for Assurant to provide hazard outsourcing services and may even be reasonable for Assurant to require the servicer utilize Assurant for insurance tracking if the servicer wants to use Assurant for LPI, it is profoundly unreasonable for these non-insurance expenses – which are associated with portfolio wide activities of the servicer – to be included in rates which are ultimately charged by the servicer to only 2% to 3% of the borrowers in the loan portfolio.

**ASCI has completely failed to justify the expense provisions in the proposed rates.**

ASIC's response to OIR regarding the tracking of expenses by insurance tracking is simply not credible. Moreover, ASIC's only public explanation of expenses in its proposed rates is the unsubstantiated declaration that "these non-insurance expenses have already been removed from the filing, as discussed with OIR."

Regarding expenses associated with the waterfall diagram of insurance tracking activities, the only documents that go out with ASIC's letterhead are the certificates of insurance and LPI policies attached to the 3rd notice letter. All three written notices are sent on the servicer's letterhead. Clearly, the expenses associated with these notices and well as the expense associated with sending the borrower the certificate of insurance and LPI policy are servicer expenses and not reasonably included in LPI rates. While the cost of printing the certificate and LPI policy sent to borrowers is a reasonable LPI expense, the requirement to send notices as well as the LPI certificate and policy is a requirement of the servicer.

In terms of call center expenses, any calls out, as well as processing of paper and EDI documents from insurers, from Assurant to ascertain the existence of required insurance is a responsibility of the servicer outsourced to Assurant and not properly included in LPI rates. The only call center activity reasonably included in LPI rates are borrower calls related to insurance coverage and claims. Clearly, such calls are a tiny percentage of overall call center activity.

ASIC's claim that it is unable to break down insurance tracking expenses by activity is not credible. ASIC states, "However, a finer distinction foes not exist, as all the costs relate to a single continuous process. The measurement of expense is only available to us at the process level, and not at a sub-process level of distinction." As the attached article from the MIT Sloan Management Review from 2011 attests, Assurant collects very detailed data on its call center operations in order to perform predictive modeling on customer calls. Given this level of data collection and analysis, it is difficult to believe that ASIC does not track customer calls by type of calls and can not identify which calls are associated with responses to first or second notices and which calls are associated with LPI claims, for example.

ASIC's claim that certain expenses cannot be assigned to a specific time frame is not credible. The issue is not allocating general expenses over the life of a policy or ULAE over the life of a claim. Rather, the issue is what expenses were actually incurred for specific activities during the calendar year for purposes of reporting in the statutory annual statement. While there can be variance in expenses by category across different time periods, this is addressed by utilizing a multi-period time frame for analysis of the expenses. The issue of expense variation is not addressed by failing to categorize the expenses.

**In conclusion, ASIC has failed to respond to OIR's request for expense provision support and has failed to justify the expense provisions in the proposed filing. Since the current ASIC rates clearly contain expenses not properly associated with the provision of LPI, ASIC's current rates are excessive and must be disapproved.**