Public Hearing before the Florida Office of Insurance Regulation
Regarding a Rate Filing for Force-Placed Insurance by
Praetorian Insurance Company

July 3, 2012

Testimony of Birny Birnbaum
On Behalf of the Center for Economic Justice

The Center for Economic Justice (CEJ) is a 501(c)3 non-profit consumer advocacy organization that advocates on behalf of low-income and minority consumers on credit, insurance and utility. CEJ has been active in credit-related insurance regulatory issues for over 15 years.

I am a consulting economist and former insurance regulator specializing in insurance rates, regulation and policy, with expertise in credit-related, auto and property insurance. I have particular expertise in evaluation of rates for credit-related insurance, including force-placed insurance. Appendix A describes my qualifications.

1. Summary of Testimony

A. The Lender-Placed Home Insurance (LPI) market is characterized by reverse competition, in which the cost of insurance placed on the borrower's loan is pushed up by LPI insurers in competition for servicers' business.

B. The LPI market is not beneficially competitive to consumers, as evidenced by numerous measures, including market concentration, high prices, low loss ratios and kickbacks to servicers.

C. Because of reverse competition, LPI insurer expenses cannot be deemed reasonable simply because the insurer incurred those expenses. With reverse competition, insurers will provide considerations to lenders and such expenses are not reasonably included in rates or passed on to borrowers.

D. Expenses permitted in LPI rates should include only those for activities directly and uniquely associated with the provision of LPI insurance. Expenses associated with servicing other the provision of LPI insurance must be excluded from rates. Such excluded expenses include commissions to servicer-affiliated producers, tracking expenses and captive reinsurance administrative fees.

E. Recent actions by state attorneys general and Fannie Mae challenge state insurance regulators to interpret and implement requirements for LPI rates to be "commercially reasonable."

F. Current and proposed LPI rates are clearly excessive and in violation of statutory rate standards. The very low loss ratios alone indicate excessive rates. Further, as soon as servicer-affiliated producers stopped accepting commissions, the LPI rates became excessive because an expense included in the filed rate was eliminated. The Department should act immediately to disapprove current LPI rates and force LPI insurers to file new rates that meet the statutory rate standards and exclude unreasonable expenses. In forcing LPI insurers to file new rates, the Department should define "commercially reasonable" LPI prices as rates that produce an expected loss ratio, including catastrophe reinsurance costs of 85% or greater.

G. The proposed rates in the Praetorian are clearly excessive. Praetorian selects a rate change of zero, despite an indicated rate of -14.6% However, the Praetorian indicated rate change is massively excessive; the reasonable indicated rate decrease is several times greater than -14.6%

H. The Praetorian indication is unreasonable and excessive because it includes excessive expense loads for commission and general and administrative expenses. The Praetorian rate indication is also unreasonable because of unreasonable premium and loss trends. The rate analysis is deficient because more current data and data broken out by Balboa IC and QBE Specialty should be used.

I. The Praetorian rate analysis is further suspect because of questionable incurred losses versus paid losses, failure to consider prior scheduled rating in establishing premium at current rate level, lack of support for the assessment of QBE rates relative to Balboa rates and the failure to analyze REO and non-REO property experience separately. The proposed scheduled rating program is arbitrary and unreasonable and the age of home rating factor, which increase rates by over 50% when a property turns 15 years old, is too blunt.

2. Mortgage Servicer Responsibilities and Lender-Placed Insurance

Mortgage servicers are entities which manage mortgage loans on behalf of the owners of the loan. The largest mortgage servicers include Bank of America, JP Morgan Chase, Wells Fargo, American Home Mortgage Servicing and GMAC who service millions of mortgages each. The largest owners of mortgages are the government-sponsored enterprises Fannie Mae and Freddie Mac. Fannie, Freddie and other mortgage owners/investors contract with mortgage servicers to perform a variety of activities to service the mortgage loans, including, among many other things, collecting mortgage payments by borrowers and distributing those funds to the proper parties.

Mortgage loan agreements include a requirement that the borrower maintain insurance to protect the property serving as collateral for the loan and, if the borrower fails to maintain the required insurance or fails to provide required evidence of insurance, the lender, through the servicer, may place insurance on the property serving as collateral for the loan and charge the borrower for this insurance.

Among other responsibilities, the mortgage servicer is required, through its servicing agreement with the owners of mortgage loan, to maintain continuous insurance coverage on the properties serving as collateral for the loan. This requirement involves two distinct activities – tracking insurance on loans being serviced and placing insurance when the borrower fails to maintain the required insurance coverage. The insurance placed by the servicer under these circumstances is called lender-placed insurance (LPI) or force-placed insurance. LPI protects the lender's collateral in the event the borrower fails to maintain insurance protecting the collateral.

It is critical to distinguish activities related to monitoring and maintaining continuous insurance on mortgage loans that are the servicer's responsibility from those activities that are the LPI insurer's responsibilities. Insurance tracking – monitoring the portfolio of loans for evidence of required insurance maintained by the borrower – is a servicer responsibility for which the servicer is paid by the mortgage owner/investor.

3. The LPI Policy and LPI Issuance Process

3.1 LPI is a Group Master Policy

The LPI insurance policy sold to the servicer is a group insurance master policy. Group insurance means that the policy covers a group of properties and not just a single property like the homeowners insurance policy purchased by a borrower. A master policy means that the policy covers all eligible properties and, as a property becomes eligible for coverage, a certificate of coverage for the individual property is issued under the master policy.

The LPI insurance policy provides that coverage begins on any property in the servicer's covered mortgage loan portfolio at the instant that the borrower's voluntary policy ceases to provide the required coverage. This provision is called automatic coverage. The LPI policy provides coverage, for example, if the borrower's homeowners insurance policy is canceled by the borrower or the borrower's insurance company or if the voluntary policy lapses because of non-payment of premium. To ensure that the property serving as collateral for its loans is always protected by insurance, the LPI policy provides coverage whenever the borrower's required insurance fails to remain in-force – even if the servicer or its vendor do not discover this failure of insurance coverage for days or weeks after the borrower's policy coverage has ended. The LPI group policy covers all properties in the servicer's loan portfolio and provides coverage as needed.

When the insurance tracking vendor notifies the LPI insurance company that there is a lapse in coverage on a property in the mortgage loan portfolio, the LPI insurer issues a temporary binder of insurance coverage retroactive to the date and time the borrower's coverage ceased to be in-force along with correspondence to the borrower on behalf of the servicer that such binder has been issued and the premium for the LPI has been added to the borrower's loan amount. The correspondence informs the borrower that the LPI coverage will be canceled if the borrower provides the required evidence of insurance coverage. This process is largely automated and conducted by a single vendor providing insurance tracking services and LPI insurance.

The LPI insurance company bills the servicer on a monthly basis for all the insurance provided. The servicer then passes along the LPI premium charges to individual borrowers, removes funds from the borrower's escrow to pay for the LPI premium, debits the borrower's escrow if there are insufficient funds to pay the premium or establishes an escrow account if one does not exist and debits the new escrow account for the amount of the LPI premium. Again, while this is a servicer responsibility, some or all of these activities are performed by the LPI insurance company or vendor on behalf of the loan servicer.

If the borrower provides evidence that there was no lapse in required insurance coverage, the LPI insurance company will refund the premium paid by the servicer and the servicer will refund the LPI amounts charged to the borrower's loan. The LPI insurance company or vendor typically performs the individual borrower refund activities on behalf of the servicer. Testimony at a recent hearing before the New York Department of Financial Services indicates that 10% to 15% of LPI insurance is flat-cancelled, which means the LPI policy was erroneously placed.

If, after the temporary binder has been issued and after a certain period of time, the borrower fails to provide evidence of required insurance, the LPI insurance company issues a certificate of insurance from the master LPI policy, typically providing a year of coverage from the original effective date of LPI coverage. The certificate of insurance names both the servicer and the borrower as insureds covered by the policy.

3.2 Servicer Recovers LPI Premiums Even In Event of Foreclosure

The servicer recovers the LPI premium it has paid to the LPI insurer, even in the event that a borrower defaults and there is a foreclosure or short sale because the LPI premiums are paid by the owner of the loan (the investor) to the servicer out of the proceeds from the foreclosure or short sale.

3.3 LPI Coverage is Limited

LPI coverage is that of a dwelling fire policy, typically providing only hazard protection. Coverages typically included in a homeowners policy and generally not included in the LPI policy are liability, personal property and additional living expense (ALE) in the event of a claim. The absence of coverage for personal property and ALE can result in a significant difference in claim costs from a catastrophe event between LPI and homeowners policies.

3.4 There is No Underwriting of Individual Properties Insured under an LPI Policy

LPI policies cover all properties in the servicer's loan portfolio and provide coverage to any property as needed.

4. Servicer vs. Insurer Responsibilities for Maintaining Continuous Insurance Coverage

There are a variety of activities associated with the requirement of servicers to ensure continuous insurance coverage. Most of these activities are the responsibility of the servicer and not the insurance company providing the LPI. Table 1 lists activities associated with the continuous insurance requirement of servicers and whether the activity is the responsibility of the servicer or LPI insurance company.

It is important to distinguish between the entity responsible for the activity in Table 1 and the entity actually carrying out the activity. Servicers typically contract with an outside vendor for most or all of the servicer responsibilities in Table 1 and that vendor is typically the insurance company providing the LPI insurance.

The servicers are responsible for insurance tracking to monitor loans to ensure borrowers are maintaining the required insurance, including requirements that the insurance policy or policies have:

- sufficient coverage amount to repair or replace the property if destroyed;
- cover the relevant perils, including fire, wind and flood, for example; and
- been issued by an insurance company with acceptable financial strength, as measured by a minimum financial strength rating by a credit rating agency.

A mortgage servicer is likely to have LPI policies for normal hazards (such as fire) and for other perils not covered by a standard homeowners policy, such as flood, excess flood, wind and excess wind. All residential property insurance policies (homeowners and dwelling fire) exclude flood as a covered peril (or cause of loss) and borrowers in designated flood areas are required by lenders to purchase a flood insurance policy from the federal government's National Flood Insurance Program. In many coastal states, insurers have excluded wind (hurricane) coverage from the standard residential property insurance policy in certain parts of the state and, consequently, borrowers must purchase a wind-only policy from a state-operated insurance program, like the Texas Windstorm Insurance Association.

Table 1
Ensuring Continuous Insurance Coverage:
Mortgage Servicer vs. Insurer Responsibilities

Activity	Servicer vs. Insurer
Tracking Insurance	
Loading Insurance Information into Database	Servicer
Maintaining/Monitoring Insurance Tracking Database	Servicer
Contacting Borrowers, Problems with Insurance	Servicer
Customer Service Borrowers Insurance Evidence	Servicer
Contacting Insurers/Agents Insurance Evidence	Servicer
Placing Insurance	
Notifying Insurer to Issue Binder or Policy	Servicer
Issuing Temporary Binder	**Insurer**
Determining Coverage Amount	Servicer
Servicer Payment to Insurer	Servicer/**Insurer**
Billing Borrower for LPI Premium	Servicer
Setting up Escrow when necessary for LPI	Servicer
Refunds to Servicer	**Insurer**
Refunds to Borrower	Servicer
Issuing Permanent Policy	**Insurer**
Customer Service about Insurance Placement	Servicer
Customer Service about Borrower Refunds	Servicer
Customer Service about LPI Claims	**Insurer**

4.1 Fannie Mae's Description of Unreasonable Expenses in LPI Premiums

Fannie Mae is a government-sponsored enterprise that purchases mortgages originated by others. Fannie Mae is the largest single owner of mortgages in the United States and contracts with mortgage servicers to service the tens of millions of mortgage loans Fannie owns. Fannie pays a fee to mortgage servicers for each mortgage loan serviced. In addition, when a mortgage owned by Fannie goes into default and the mortgaged property is foreclosed, Fannie pays any outstanding LPI premium due on the defaulted loan to the servicer. In a recent request for proposal[1] for insurance tracking and LPI, Fannie Mae also describes the problem with unreasonable expenses included in LPI premium charges.

[1] See Appendix B for the Fannie Mae RFP

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:

1. Homeowners are required to maintain voluntary hazard insurance on Fannie Mae insured properties.

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.

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.

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.

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.

The situation Fannie describes is reverse competition in LPI markets – where the price of LPI is inflated because of considerations to the mortgage servicer built into the LPI rates which are paid for by the 1-2% of borrowers who are charged LPI premiums. For example, in the recent LPI hearing in New York held by the Department of Financial Services, one mortgage servicer testified that it contracted with Balboa for insurance tracking, but paid no fee for that service. Balboa provided the insurance tracking without charge in exchange for providing the LPI on the servicer's portfolio. Another mortgage servicer testified that ZC Sterling – which became QBE First after acquisition by QBE – paid the servicer $9 million in addition to commissions for marketing. Consequently, LPI rates include inappropriate expenses – expenses not associated with the provision of insurance or the transfer of risk.

5. LPI Market Participants and Results

There has been dramatic growth in the amount of LPI insurance countrywide and in Florida over the past eight years, as shown in Table 2. Countrywide net written premium grew $800 million to $3.5 billion. Florida LPI net written premium grew by a factor of 15 from $84 million to $1.2 billion.[2] Gross written premium means the total premium on policies issued during the year before any refunds. Net written premium is gross written premium less premium refunded. Assurant has been the major writer of LPI with over 50% of the market. Florida's share of the countrywide total has grown to over one-third from 2009 to 2011.

Table 2
Florida and Countrywide LPI Premium, 2004-2011s
($ Millions)

	Florida	Countrywide	FL Share
2004	$84.19	$796.22	10.6%
2005	$99.28	$918.74	10.8%
2006	$142.81	$1,074.36	13.3%
2007	$294.66	$1,647.10	17.9%
2008	$506.91	$2,209.33	22.9%
2009	$1,046.56	$3,048.94	34.3%
2010	$1,184.11	$3,223.27	36.7%
2011	$1,211.26	$3,449.80	35.1%
2004-11	$4,569.80	$16,367.76	27.9%

[2] The source of the data in this table is Credit Insurance Experience Exhibit data from the creditor-placed home columns of part 4 plus the experience of QBE Insurance Corp and QBE Specialty reported in part 5 Other..

Table 3 shows that in 2009 and 2010, LPI represented a significant portion – about 15% of the total of LPI and homeowners premiums in Florida. The amount of Florida LPI is massive in both absolute dollar volume and as a share of total residential property premium. I estimate that 1-2% of mortgage borrowers have LPI placed on their loans – in sharp contrast to the 14% share of LPI premiums.

Table 3
Florida LPI and Homeowners Premium
($ Millions)

Year	LPI	Homeowners	LPI Share of Total
2009	$1,184.11	$6,932.27	14.6%
2010	$1,211.26	$7,568.47	13.8%

Average LPI premiums are much higher than average homeowners premiums. Table 4 shows the average LPI premium for Balboa Insurance Company and QBE Specialty based on combined data presented in the rate filing. The companies' own data show average LPI premiums reaching $6,535 in the 2008-09 period.

Table 4
Balboa/QBE Average LPI Premium, 2006 - 2011

Year	Exposures	Written Premium	Average Premium
7/06-6/07	15,956	$37,427,737	$2,346
7/07-6/08	25,520	$125,281,407	$4,909
7/08-6/09	45,451	$297,001,037	$6,535
7/09-6/10	97,567	$596,331,000	$6,112
7/10-6/11	119,611	$589,176,927	$4,926

Table 5 shows Florida LPI net written premium, paid to written loss ratios and incurred to earned loss ratios for Balboa IC and QBE Specialty, as reported in the Credit Insurance Experience Exhibit to the statutory annual statement. Table 5 shows massive growth by Balboa from 2008 to 2009 and very low loss ratios from 2007 through 2011. QBE grew quickly from its start in 2009 and also shows very low loss ratios. Table 5 also shows significant and persistent differences between paid loss ratios and incurred loss ratios.

Table 5
Florida LPI Net Written Premium and Loss Ratios for Balboa IC and QBE Specialty

Year	Balboa IC	Paid LR	Incurred LR
2004	$22,539,043	63.8%	74.0%
2005	$25,449,604	46.8%	82.0%
2006	$26,939,907	64.3%	28.1%
2007	$51,516,777	8.7%	10.7%
2008	$97,452,240	7.4%	9.2%
2009	$464,463,676	3.8%	13.7%
2010	$431,916,007	3.7%	2.4%
2011	$430,911,925	5.7%	9.2%
2004-2011	$1,551,189,179	7.3%	10.6%

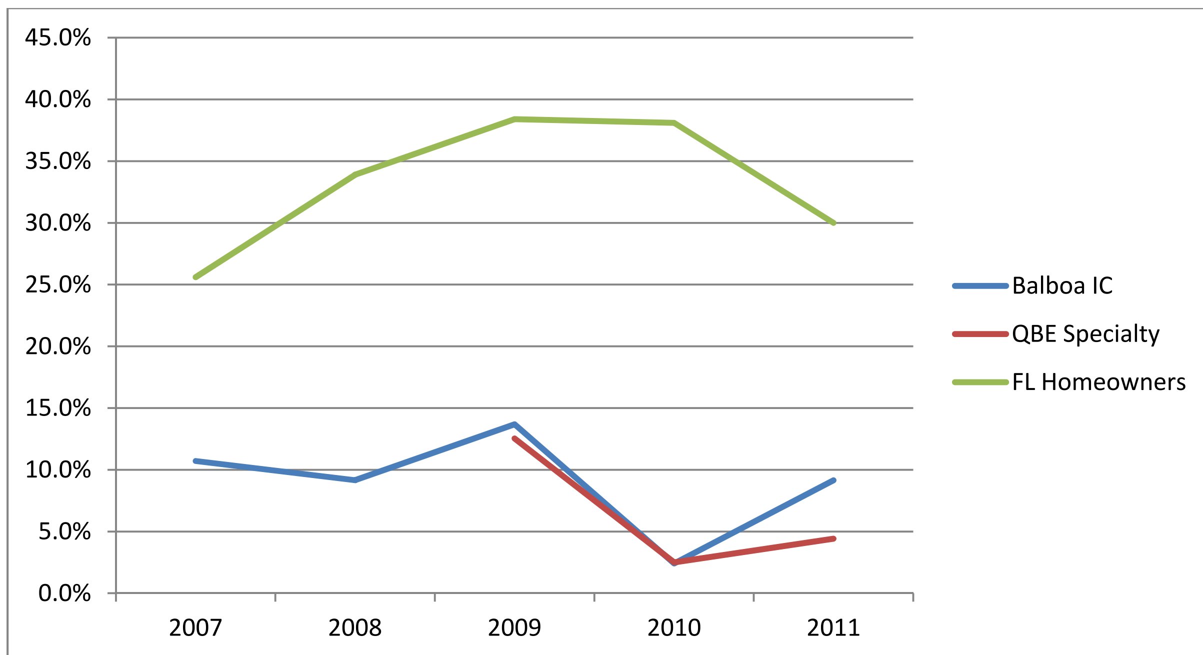
Year	QBE Specialty	Paid LR	Incurred LR
2004			
2005			
2006			
2007			
2008			
2009	$101,500,912	0.3%	12.5%
2010	$212,608,944	0.1%	2.5%
2011	$194,446,072	4.7%	4.4%
2004-2011	$508,555,928	1.9%	4.7%

Years	Combined	Paid LR	Incurred LR
2004-2011	$2,059,745,107	6.0%	9.1%
2005-2011	$2,037,206,064	5.4%	8.3%
2006-2011	$2,011,756,460	4.8%	7.4%
2007-2011	$1,984,816,553	4.0%	7.0%
2008-2011	$1,933,299,776	3.9%	7.0%
2009-2011	$1,835,847,536	3.7%	6.8%

Table 6 shows Balboa IC and QBE Specialty Florida LPI incurred loss ratios have been significantly below the Florida aggregate homeowners loss ratio in each year from 2004 through 2011. The chart below Table 6 graphs the data in the table.

Table 6
Incurred Loss Ratios: Balboa and QBE LPI vs. Florida Homeowners

Year	Balboa IC	QBE Specialty	FL Homeowners
2004	74.0%		303.0%
2005	82.0%		153.6%
2006	28.1%		32.6%
2007	10.7%		25.6%
2008	9.2%		33.9%
2009	13.7%	12.5%	38.4%
2010	2.4%	2.5%	38.1%
2011	9.2%	4.4%	30.0%



5.1 QBE Specialty Selling LPI through Surplus Lines

Florida prohibits a policy from being issued through surplus lines insurers unless the coverage under the policy is "eligible for export."[3] A coverage is eligible for export – eligible for sale through surplus lines – if the coverage meets a number of criteria.[4] One requirement is:

> (a) The full amount of insurance required must not be procurable, after a diligent effort has been made by the producing agent to do so, from among the insurers authorized to transact and actually writing that kind and class of insurance in this state, and the amount of insurance exported shall be only the excess over the amount so procurable from authorized insurers.[5]

QBE Specialty is a surplus lines insurer and the LPI sold by QBE Specialty is surplus lines insurance. It is unclear how QBE Specialty has met or can meet the Florida surplus lines requirements for LPI to be eligible for export when the coverage has been available and continues to be available from admitted carriers, including Balboa IC and American Security IC.

6. Detailed Analysis of Commissions, Other Acquisition and General Expenses

As a preliminary matter, the only potentially substantive justification for the proposed expense provisions is Exhibit 21 of the filing – "Letter of Intent on Commissions." Praetorian has claimed this information as a trade secret and the exhibit is not available to the public for review. Given that a prior Balboa IC LPI filing has contained materially false statements[6], it is reasonable and necessary for Exhibit 21 to be available for public inspection and review.

The filing contains unreasonable expense provisions – 15% for commissions, 2.4% for other acquisition expenses and 11.5% for general expenses for a total of 28.9%. The selection of expense provisions is completely arbitrary, without empirical or logical support and unreasonable on its face. Table 7 shows the three-year averages for commissions, other acquisition and general expenses for fire and homeowners lines in Florida from 2008 to 2010.[7]

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[3] Florida Insurance Statutes 626.915(1)

[4] Florida Insurance Statutes 626.916(1)

[5] Florida Insurance Statutes 626.916(1)(a)

[6] For example, in OIR Filing No. 10-20376, Balboa wrote to OIR Actuary Robert Lee and stated: Confirm no expense in this filing relates to activities that solely relate to bank or mortgage entity not related to insurance transaction. *RESPONSE: The insurance expenses used to support this filing are pulled from the Insurance Expense Exhibit which makes a part of our NAIC financial statements. The expenses identified in the IEE do not include any activity solely related to banking, mortgage lending, or mortgage servicing or any entity not related to the insurance transaction.* Earlier, in the letter, Balboa described expenses for activities specifically related to the insurance tracking activities of mortgage servicers, contradicting the response regarding non-insurance expenses.

[7] The Florida fire and homeowners figures are a weighted average of data reported in the OIR Annual Reports of 2009, 2010 and 2011, Florida Property and Casualty Insurance Calendar Year Experience pursuant to Section 627.915 (2), FS.

Table 7
Florida Homeowners and Fire Expenses vs. Praetorian Expenses

	Homeowners	Fire	Praetorian LPI
Other Acquisition	6.60%	3.61%	2.40%
General Expense	3.76%	4.41%	11.50%
Commission	12.91%	10.43%	15.00%
Total	23.26%	18.44%	28.90%

We would expect much lower historical expense provisions as a percentage of premium for LPI than for homeowners or fire for at least two reasons. First there are far fewer activities and related expenses for the sale and administration of a group master policy with no underwriting of individual properties than for individually-underwritten and individually-sold residential property insurance policies. Stated differently, expense dollars per property insured should be much less for LPI than for homeowners or fire.

For LPI, the LPI insurer issues a group master policy and, upon notification by the servicer, issues coverage for specific properties. The LPI insurer administers the group master policy, typically billing monthly for coverage issued during the period. The LPI insurer settles claims under the LPI policy and answers questions from the servicer and borrowers about claim settlement. The insurer must develop rates for the LPI insurance.

Contrast these few activities with those of an agent and insurer for homeowners insurance. The insurer and agent constantly seek to solicit new business via marketing and advertising and to maintain existing customers with customer service and communication. The sale of a homeowners policy involves the collection of large amounts of information about the consumer and the property, including credit history, loss history reports and other information for underwriting. The agent and insurer must work with the consumer to establish the coverages needed and the appropriate amount of coverage. The agent commission covers the expenses associated with agent's activities for marketing, new business solicitation, sales, underwriting, rating, customer service and assistance with claims. The insurer expenses cover the costs of advertising and marketing for sales and customer retention, developing sophisticated underwriting and rating systems, obtaining detailed underwriting and rating data for the sophisticated rating, issuing complete homeowners policies to new policyholders, customer service and claims settlement.

Second, because the average premium for LPI is much greater than the average premium for homeowners or fire, the same expense dollars per property insured should produce a much lower expense percentage of premium. With fewer expenses and higher average premium per property insured for LPI than homeowners, the expense percentages for LPI should be significantly less than those for homewoners. The Praetorian filing proposes higher expense percentages applied to higher average premium, which would produce expense dollars per

property insured for LPI multiples greater than the expense dollars per property insured for homeowners. The proposed expense provisions are clearly unreasonable and excessive.

The filing's public justification for these expense provisions consists of the following statements:

> Exhibit 13A displays both historical and prospective expenses. The selected expenses are based on future anticipated expenses and industry data. American Security Insurance Company figures are shown 13A for comparison. Our selections are in line with industry standards, and American Security Insurance Company represents the only direct competitor which writes this business on an admitted basis.
>
> The most recent Balboa filing made for the Risk Based Protection product noted that commission expense was projected based on expected market demands and the commission expense reflected in competitor programs. The combination of the Balboa business with the QBE Specialty business contemplates the payment of reasonable commissions to unaffiliated business partners. The commission expense used in this filing reflects the existing combination commission obligation of Praetorian and the expected commissions necessary to acquire new business commensurate with industry standards. Exhibit 21 details the commission expense reasonably expected and summarizes the services we expect to receive in return for payment of those commissions.

This explanation is gibberish. Exhibit 13A of the filing shows five-year historical average expenses of 4.7% for commissions, 2.3% for other acquisition and 9.4% for general expenses. Praetorian ignores these actual historical values and selects higher amounts, presumably because American Security's approved filing includes higher expense provisions. All three sets of expense provisions – Balboa IC historical average, Praetorian proposed and American Security – are unreasonable and excessive because the expenses are inflated by expenses associated with considerations for the mortgage service, including expenses for mortgage servicing activities.

6.1 Reverse Competition in LPI Markets Leads to Unreasonable Expenses

Reverse competition describes a market structure in which consumers/borrowers exert little or no market power over prices. Instead of competing for individual consumers, insurers compete for the entities with the market power to steer the ultimate consumer to the insurer. Insurers compete for the servicer's business by providing considerations to the servicer, with the cost of such considerations passed on to the borrower. Greater competition for the lender's business leads to higher prices of credit-related insurance, including LPI, to the borrower. This form of competition, which results in *higher* prices to consumers, is called reverse competition. The Fannie Mae RFP, cited above, describes this dynamic in LPI markets.

Because of reverse competition, LPI insurer expenses cannot be deemed reasonable simply because the insurer incurred those expenses. With reverse competition, insurers will provide considerations to lenders and such expenses are not reasonably included in rates or passed on to borrowers.

6.2 Consumers Are Especially Vulnerable to Excessive LPI Rates

The incentives and potential for excessive LPI rates are great. Consumers do not request the insurance, but are forced to pay for it. The cost of LPI is much higher than a policy the borrower would purchase on his or her own. Servicers have financial incentive to force-place the insurance because the premium includes commission and other consideration for the servicer. With some servicers, the insurance is reinsured through a captive reinsurer of the servicer, resulting in additional revenue to the servicer from the force-placement of the coverage.[8]

Borrowers are vulnerable to excessive rates for LPI insurance because the borrowers / consumers exert no market power in the setting of these rates. The insurance is force-placed on the borrower and the borrower has no say or decision in the amount or type of coverage placed. In addition, there is no downward market pressure on rates; the vendors/insurers offering LPI do not compete on the basis of price, but on the basis of services provided to the lender and compensation and other considerations provided to the lender or its affiliates.

6.3 Unreasonable Expenses

Because of reverse competition, borrowers are charged unreasonable LPI premiums because of unreasonable expenses included in the LPI premium. To compete for servicer business, LPI insurers must provide considerations to the lender. This cost of these considerations – payments by the LPI insurer to the servicer or expenditures by the LPI insurer to subsidize the servicer's cost for non-LPI activities – inflate the LPI premium beyond the reasonable costs of providing the insurance. Unreasonable expenses included in LPI rates include:

- Tracking/Servicing Activities Unrelated to the Provision of LPI
- LPI Commissions
- Captive Reinsurance Administrative Costs
- Affiliate Transactions at Above-Market Prices
- Flat Cancellations

6.3.1 Tracking and other Servicer Activities

Table 1 provides a list of LPI-related activities and identifies the activities as associated with servicing a portfolio of loans versus the issuance and administration of the LPI master policies and individual property coverages.

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[8] See, for example, "Ties to Insurers Could Land Mortgage Services in More Trouble," Jeff Horwitz, *American Bankers*, November 10, 2010.

Although most of the activities in Table 1 are servicing activities, most or all of these activities are typically performed by the LPI vendor for the servicer. Some of these services may be billed separately from the LPI premium, but some portion of the LPI insurer's expenses are for performing servicer activities not a part of the provision of LPI. Such expenses are unreasonable to include in LPI premium charges to borrowers.

As in Table 1, the Fannie Mae RFP draws a clear distinction between insurance tracking and the provision of LPI insurance. The LPI requirements in the RFP are limited to issuance of insurance, settlement of claims under policy, customer service regarding claims. The LPI critical performance indicators are for speed of unearned premiums refunds, insurance placement and claim settlement. The key performance indicators are for claims call answer speed, damage inspection speed, estimated repair cost verification speed and call center abandonment rate.

Expenses for other loan servicing activities, including, for example, insurance tracking, customer service related to insurance tracking and billing borrowers for LPI, are expenses associated with the servicing the entire loan portfolio and are not reasonable to include in LPI premiums charged to 1%-2% of borrowers.

6.3.2 Commissions to Servicer-Affiliated Producers

At a recent hearing before the New York State Department of Financial Services, mortgage servicers testified about commissions paid to servicer-affiliated insurance agents (also known as producers). I monitored the hearing and provided testimony following the servicers and LPI insurers. Testimony at this hearing, in my opinion, revealed that commissions paid to servicer-affiliated producers are not justified by any service provided by these producers and represent a kickback to the servicer for placing the LPI. When asked what activities the servicer-affiliated producers perform to justify the commissions, the responses included:

- Soliciting LPI providers
- Reviewing LPI form letters and other documents
- Third-party broker commissions are commonplace
- Broker commissions are an accepted and approved practice
- LPI broker commissions are similar to those in other lines of insurance
- Manage the LPI rating program
- Manage the LPI vendor relationship
- Quality review of the LPI vendor
- Commissions are a cost of doing business

The classic role of the insurance producer is to help the policyholder determine her insurance needs and shop the market for the insurance product that meets the policyholder's needs while seeking the most competitive price for the product. Such activities simply do not exist in LPI because historically there were only three national providers of the necessary package of insurance and related services and there is no price competition among the insurers. With QBE's acquisition of the Balboa LPI business from Bank of America, soliciting new

business consists of asking typically two vendors for proposals – and such activity is a rare event for most servicers.

Reviewing LPI form letters and other communication templates is the servicer's responsibility. A servicer-affiliated producer performing such review is performing servicer activity which should not be compensated for through LPI insurance premiums.

The fact that third-party broker commissions are commonplace or a standard industry practice in LPI or other lines of insurance is no justification for such commissions in the LPI market. There have been a variety of standard industry practices by servicers and insurers that were unfair and abusive to consumers – and which were not justified by virtue of many servicers or insurers engaging in the same practice. In the servicing realm, recent settlements between states and servicers have identified a number of unfair industry practices, such as robosigning foreclosure documents. In the insurance realm, steering of business based on contingent commissions, unfair use of retained asset account and abusive sales of financed single premium credit insurance, were industry standard practices, to name a few.

Other justifications cited by industry witnesses –managing the LPI vendor relationship and quality review of the LPI vendor – are responsibilities of the servicer and, to the extent the servicer-affiliated producer is performing these activities, the commissions to these producers represent a kickback of the LPI premiums to subsidize servicer activities.

In summary, just as in the Praetorian filing, industry witnesses in New York provided no justification for any LPI commissions to servicer-affiliated producers. Fannie Mae's new policy – to not reimburse servicers for any portion of LPI premiums paid as commission to servicer-affiliated producers and described in the next section – provides further evidence that no commissions to servicer-affiliated producers are warranted.

6.3.3 Fannie Mae Servicing Guidelines for LPI

On March 14, 2012, Fannie Mae issued new guidelines to mortgage servicers regarding LPI.[9] The new guidelines mandate that LPI premiums exclude certain unreasonable expenses, including commissions to servicer-affiliated producers and expenses associated with insurance tracking. The Fannie Mae servicer guidelines are consistent with the evaluation by Fannie Mae in its LPI RFP that LPI premium charges are unreasonably inflated by expenses unrelated to the provision of LPI insurance.

[9] Fannie Mae, *Servicing Guideline SVC-2012-04, Updates to Lender Placed Property Insurance and Hazard Insurance Claims Processing,* March 14, 2012, available at https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2012/svc1204.pdf

Acceptable Lender-Placed Insurance Costs and Insurance Tracking Fees

Fannie Mae is clarifying its requirement for reasonable reimbursable expenses for lender-placed insurance. Any servicer request for reimbursement of lender-placed insurance premiums must **exclude**:

- any lender-placed insurance commission earned on that policy by the servicer or any related entity,
- costs associated with insurance tracking or administration, or
- any other costs beyond the actual cost of the lender-placed insurance policy premium.

The Praetorian filing cites one aspect of the Fannie Mae servicing guideline to justify higher rates – increased deductibles in support of its premium trend selection – but fails to mention other parts of the servicing guideline that justify lower rates because of lower expenses. The Fannie Mae guideline will result in fewer commissions paid on LPI. In fact, two major servicers – AHMSI and Chase – announced at the New York Department of Financial Services hearing in May, 2012, that they will no longer accept commissions on LPI placed on loans in their portfolios. It is likely that other servicer-affiliated producers will also cease accepting LPI commissions.

6.3.4 QBE Acquisition of Balboa / 10-Year Agreement for Bank of America Business

In June 2011, QBE acquired, among other things, the Balboa LPI business from Bank of America (BOA).[10] The acquisition included a ten-year agreement for Bank of America to use QBE for LPI. Since BOA was and remains one of the largest mortgage servicers, the BOA LPI business represents a significant portion of the QBE/Praetorian LPI business. There is no reason for Praetorian to pay a commission for the BOA LPI business as no producer services or other acquisition expenses are needed to maintain the BOA LPI business.

6.3.5 Quota Share Reinsurance

Quota Share reinsurance arrangements – in which the LPI insurer reinsures a portion of LPI business with a reinsurance company typically owned or affiliated with the servicer – are simply profit-sharing mechanisms designed to provide additional considerations to the servicer. These arrangements serve no substantive risk management purpose and, consequently, serve no purpose for the consumers/borrowers of LPI.

Captive LPI reinsurance arrangements should be prohibited because they create a conflict of interest between the servicer and the borrower. By having a financial interest in the price and placement of LPI through a captive reinsurance program, the servicer has a glaring conflict with

[10] Appendix C has news reports describing the transaction

the interest of the borrower for lower-cost LPI. Testimony of industry witnesses in NY – "we can see that there might be a perception of a conflict, but it does not affect our practice" – does not address or eliminate the actual conflict of interest. The person who has a conflict of interest does not eliminate the conflict simply by saving, "I'm not affected by these financial incentives."

Regardless of whether the captive reinsurance arrangements are prohibited, the expenses associated with administering the arrangements should be excluded from LPI rates because these expenses provide no benefit for the borrower charged the LPI premium.

6.3.5 Affiliate Transactions

LPI expenses for both Balboa and QBE include significant affiliate transactions. QBE First has testified that the QBE insurers pay a significant commission to QBE First to administer the LPI program. Expenses for affiliate transactions should be identified and reviewed for reasonableness to ensure that such affiliate transaction expenses are not insurer profit characterized as expense.

6.3.6 Flat Cancellations

When LPI coverage is issued and the servicer discovers that the borrower had, in fact, the required insurance on the property, the LPI premium is fully refunded. Testimony at the New York DFS hearing in May, 2012 indicated 10% to 15% of LPI policies were flat-cancelled, meaning the policies were placed in error and premiums fully refunded. The expenses associated with these flat cancellations to the insurer – issuing a temporary binder, removing the coverage, billing the servicer and refunding premium to the servicer – should be borne by the servicer and not the borrowers charged LPI premiums. Flat cancellations occur because the servicer erroneously directed the LPI insurer to issue coverage. These errors may have resulted from poor work by the servicer or its vendor performing insurance tracking. Or the errors may have resulted from borrowers not providing information in a timely fashion. Since there is no charge to consumers who are late providing insurance information – there is a flat cancellation – the cost of flat cancellations is an expense associated with servicing the portfolio. The cost of flat cancellation should not be borne by the small percentage of borrowers who are actually charged LPI premiums.

6.4 Reasonable Expense Provisions

The reasonable expense provisions are those for which the activities are clearly related to the transfer of risk with LPI insurance and for which Praetorian can demonstrate it will incur that expense. Praetorian should document the expenses associated with specific LPI activities and those expenses should be reviewed to ensure the expense is relevant for LPI and reasonable.

Commissions	0% to 2%
Other Acquisition Expense	2% to 3%
General Expense	3% to 4%
Total	5% to 9%

No provision for commissions is warranted for insurer-affiliated and servicer-affiliated producers. Commissions for non-affiliated producers should be documented and, if legitimate, a commission provision based on a premium-weighted average actual non-affiliated producer commissions and zero for affiliated producers. Many servicer-affiliated producers have already stopped accepting commissions on LPI because of the new Fannie Mae policy and other servicer-affiliated producers will soon stop accepting commissions on LPI insurance. Further, servicer-affiliated producers do nothing to warrant a commission. Industry testimony about the activities of servicer-affiliated producers indicates the activities of these producers are really vendor management oversight by the servicers. The costs of these vendor management activities are servicer responsibilities and not a reasonable LPI insurance expense.

Absent any concrete evidence to the contrary, a range of 2% to 3% is a maximum provision for other acquisition expense. Unlike personal lines insurance, there is no advertising to consumers (borrowers). Many mortgage servicers – and certainly the larger mortgage servicers – operate in many or all states. Given that there are only two national LPI insurers and servicers know who these insurers are, the LPI insurers do not require significant expense to solicit business; rather, the LPI insurers will typically respond to solicitations.

To put this in perspective, a 2% provision for other acquisition provides $10 million annually for $500 million in annual premium. This is a significant amount of money for other acquisition for LPI in Florida. As stated above, the following activities, present for homeowners insurance, are not found for LPI.

- Development of complex underwriting and rating models
- Development of complex premium calculation models and software
- Underwriting of individual properties and policyholders, including credit reports, credit scores, claims history reports and other property-or-consumer specific data
- Interaction with individual policyholders to determine appropriate coverage amount and coverages for the policy
- Sales and underwriting activity not resulting in a policy, including, for example, obtaining credit scores and loss history reports for applicants who do not purchase a policy.

Absent any concrete evidence to the contrary, a range of 3% to 4% is a maximum for general and administrative expense. As discussed above, the general and administrative expenses associated with a non-underwritten group blanket policy must be significantly less than general and administrative expenses associated with homeowners insurance. The following expenses for homeowners insurance are not found for LPI:

- Maintenance of detailed underwriting, rating and coverage information on individual policyholders
- Billing of individual policyholders

7. Detailed Analysis of Non-Expense Provisions of Rate Filing

As a preliminary matter, several key rate development issues could not be analyzed because the supporting documentation was claimed a trade secret and not available to the public.

As with the expense provisions, the requested rate bears no relation to the rate indicated by the Praetorian data analysis and is based on unsupported claims about the LPI market. The filing states:

> The overall indication emphasizes the more recent loss data that shows increasing loss frequency and recent regulatory trends expected to reduce future premium. The company anticipates these trends will continue. Significant market uncertainty remains with respect to lender placed insurance, in addition to the specific actions noted in the trend discussion below. The market is characterized by large volumes of seriously delinquent loans, changing loan servicing and loan modification requirements, and a persistent backlog of REO properties. The increasing market uncertainty and the recent premium and loss trends support the company's selected rate change for this filing.

The only regulatory change cited by Praetorian in its filing is a change in deductibles required by Fannie Mae. The filing does not mention other changes in the Fannie Mae LPI guidelines – changing coverage amount to unpaid principal balance after a loan with LPI goes 120 days delinquent and Fannie's refusal to reimburse servicer-affiliated producer commissions and tracking expenses included in LPI premiums.

Praetorian cherry picks the regulatory changes to maximize the indicated and selected rate. While using higher deductibles to justify a more negative premium trend than indicated by the data, Praetorian ignores the impact of higher deductibles in its loss trend analysis.

The requirement by Fannie to change coverage amounts to unpaid balance at 120 days delinquent does not necessarily mean a lower amount of coverage. A significant number of mortgages are underwater – meaning that more is owed on the home than the home is worth. The fourth quarter 2011 negative equity report from CoreLogic[11] shows that around 43% of Florida mortgages have negative equity.

[11] http://www.corelogic.com/about-us/researchtrends/asset_upload_file866_14435.pdf

Praetorian's argument that higher-than-indicated rates are needed because of "market uncertainty" and because of "large volumes of seriously delinquent loans, changing loan servicing and loan modification requirements, and a persistent backlog of REO properties" is without empirical support. The LPI market has been characterized by uncertainty, large volumes of seriously delinquent loans, changing loan servicing requirements and a backlog of REO properties for several years. Serious mortgage delinquencies peaked in 2010 and have declined significantly since then, though the numbers are still far above historical norms. There is simply no actuarial or economic basis for the Praetorian selected LPI rate and rate justification.

Some of the most glaring problems with the actuarial analysis in the filing are now discussed.

7.1 Ignored Indication

The filing shows an indicated rate change of -14.6%. Yet, the filer selects a zero rate change. The indicated rate change from a reasonable analysis is at least three times greater than the filer's indication.

7.2 Data Time Frames

The filing presents premium and loss data from third quarter 2006 through second quarter 2011, evaluated as of September 2011. The filing was filed with the Office on May 4, 2012. It is unclear why calendar accident year data through fourth quarter 2011 was not presented, since such data was available at the time of filing.

The use of other-than-most-currently-available data poses problems. First, the impact of the negative premium and massive positive loss trends are increased. Second, it is not possible to reconcile the data presented to any calendar year report, such as the statutory annual statement or Credit Insurance Experience Exhibit. Third, the premium and loss data are mismatched with expense and LAE data because the former are based on a July through June 12-month period, while the latter are based on a January through December 12-month period.

7.3 Balboa IC and QBE Specialty Combined vs. Separate Experience

The premium and loss data, including premium and loss trend data, are presented on a combined basis for Balboa IC and QBE Specialty. The combination of the data may skew results, particularly for trend analysis and loss development. The data should be presented separately for Balboa IC and QBE Specialty to allow review of individual company data for anomalies for individual company experience or combined experience.

7.4 Paid vs. Incurred Losses

Table 5, above, shows significant and persistent differences between paid and incurred loss ratios. While it is reasonable to expect paid loss ratios to lag incurred loss ratios for a short time when premium is growing, the disparity between paid and incurred loss ratios for both Balboa and QBE persists when premium growth stabilized. The high incurred loss ratios relative to paid loss ratios suggest that one or both insurers are over-reserving and, consequently, overstating incurred losses during the period of experience review.

7.5 QBE Rate vs. Balboa

The filing claims that the current average QBE Specialty rates are 10.5% higher than the Balboa rate level. The filing asserts the rate differential was calculated by rerating QBE Specialty policies using current Balboa IC rates (Exhibit 5C). No support or evidence is provided for this assertion, which has impact on the premium at current rate level analysis. Data in the filing do not support this assertion of rate differential. Exhibit 24 – Overall Premium Impact Calculation – shows the current number of property risks and total premium for Balboa IC and QBE. The average premium for Balboa IC is $352,100, 194 / 87,678 equals $4,015.83. The average premium for QBE Specialty is $108,558,904 / 26,432 equals $4,107.10. The average QBE premium is only 2.3% greater than the average Balboa premium.

7.6 Scheduled Rating Impact

Balboa's prior filings include scheduled rating, which is a deviation from the filed and approved base rates at the discretion of the insurer up to + / - 25% of the base rates. The presence of significant schedule rating credits would mean that the actual net written premium was at rates significantly below the filed and approved rates. There is no indication of any consideration of scheduled rating in the rate development analysis. Yet, Exhibit 24 indicates that significant scheduled rating credits were awarded. The scheduled rating factor for Balboa in the Exhibit 24 for current experience is 0.751, indicating an average scheduled rating credit of 24.9% If this is accurate, then actual premiums at current rate levels for Balboa are about one-third higher than presented.

Presumably, QBE Specialty also employed scheduled rating, but no data are provided for current or historic QBE scheduled rating.

7.7 Premium Trend

The filing proposes a premium trend of -3.0% based, in part, on an analysis of changing average amounts of insurance (Exhibit 9) and, in part, on the following:

The largest purchaser of residential mortgages, Fannie Mae, announced that effective June 1, 2012, changes in deductible requirements and coverage requirements for lender placed insurance. These changes will reduce premium, and the premium trend shown likely underestimates the impact of the Fannie deductible and coverage policy revisions.

The premium trend analysis and selection are massively flawed and must be rejected:

- Fannie has delayed the effective date of the new LPI requirements and has not announced a new effective date, so this rationale is currently not valid.

- The proposed rates provide a rate reduction of 1.1% for non-hurricane and 1.8% for hurricane for moving from a $500 to $1,000 deductible. The impact of Fannie's new requirement is likely to have a fraction of these rate impacts because some servicers are likely already using the higher deductible.

- The data used for the premium trend analysis is not actual premium, but amount of insurance. Based on the proposed amount of insurance factor in the filing, a 1% change in amount of insurance results in less than a 1% change in the premium. Increasing the amount of if insurance from $200,000 of coverage by 1% to $202,000 of coverage increases the premium by 0.5%.

- The premium trend data are likely skewed by the combination of Balboa and QBE experience. Exhibit 5C shows that QBE premium started in second quarter 2009 and increased significantly in the third and fourth quarters of 2009. Exhibit 9 shows that the average amount of insurance jumped from second quarter 2009 to third quarter 2009 when the QBE experience was supplementing the Balboa experience. The result was a high point for average amount of insurance.

- The premium trend selection of -3.0% bears no relation to the amount of insurance data presented in Exhibit 9. The table below shows the average amount of insurance (AOI) by quarter from Exhibit 9 and the 12-month average by quarter. The filer is only able to produce a negative premium trend by relying on the most recent years – four and eight points. If the analysis was based on ten or more points, the premium trend is positive.

- The premium trend selection produces the absurd result of applying a -3% premium trend – for over six years -- to the four-quarter period ending second quarter 2007 even though the average amount of insurance for that period of $148,252 was over 25% less than the most recent four-quarter period ending second quarter 2011. Similarly, over five years of -3% premium trend is applied annual experience ending second quarter 2008 even though the average amount of insurance for that period almost 20% less than the most recent four-quarter period ending second quarter 2011.

- LPI insurers have no say in which properties are insured. Past amounts of insurance are not a guide to future amounts of insurance for new properties insured. The amount of insurance is predominantly determined by the type of property for which the borrower fails to provide evidence of insurance, which is a function of the state of the real estate market and the economy.

Table 8
Praetorian Premium Trend Data

Quarter	Average AOI	12-Month Average AOI	Trend Analysis Points	Exponential Trend
2006Q3	133,759			
2006Q4	141,440			
2007Q1	153,093			
2007Q2	160,340	**148,252**	17	7.4%
2007Q3	173,234	158,438	16	6.1%
2007Q4	181,488	168,502	15	5.0%
2008Q1	184,520	175,962	14	4.0%
2008Q2	194,007	**184,558**	13	2.9%
2008Q3	195,749	190,009	12	2.1%
2008Q4	199,315	194,298	11	1.2%
2009Q1	205,325	199,152	10	0.2%
2009Q2	207,447	**202,794**	9	-0.7%
2009Q3	213,305	207,594	8	-1.7%
2009Q4	211,522	210,104	7	-2.4%
2010Q1	208,588	210,301	6	-2.4%
2010Q2	200,512	**207,775**	5	-1.8%
2010Q3	204,072	205,753	4	-1.2%
2010Q4	205,593	204,555		
2011Q1	204,603	203,696		
2011Q2	201,947	**204,035**		

7.8 Loss Trend

Praetorian selects an annual loss trend of 23.9%, which, combined with the premium trend of – 3.0% produces an annual net trend 27.7% The filing justifies the selection by stating the "selected loss trend reflects the significant increase in frequency experienced in recent periods."

The loss trend is clearly unreasonable and excessive. If the loss trend was actually 23.9% and the annual trend was actually 27.7%, we would expect to see massively deteriorating loss ratios. The actual loss ratios show no such deterioration. Even following a 15% rate reduction effective October 1, 2010, the Balboa loss ratio for 2011 remained below 10%.

Table 9
Recent Actual Florida LPI Loss Ratios for Balboa IC and QBE Specialty

Year	Balboa IC
2007	10.7%
2008	9.2%
2009	13.7%
2010	2.4%
2011	9.2%

Year	QBE Specialty
2009	12.5%
2010	2.5%
2011	4.4%

The loss trend selection is unreasonable because it fails to consider the impact of higher deductibles utilized by Praetorian in the premium trend selection. If higher deductibles are a valid consideration for premium trends, then the higher deductibles must be considered in the loss trend. No consideration of higher deductibles was given by Praetorian for the loss trend.

The loss trend selection is unreasonable because it selects the trend based on only five data points and, despite the claim that the rate selection is based on recent claim frequency increases, does not include the most recent data point of 12-months ending second quarter 2011. Table 10 shows annual loss severity, frequency and pure premium trends using Praetorian loss trend data for various analysis periods including the last data point and excluding the last data point. The Praetorian selection – five points excluding the last data point – is highlighted in bold. Had Praetorian selected the pure premium trend based on six points (excluding the most

recent point), the loss trend would have been 7.5% instead of 23.9%. Had Praetorian selected seven or more points, the loss trend would have been negative. The selection of a loss trend based on few data points to emphasize recent experience, while eliminating the most recent data point is arbitrary and unreasonable.

The loss trend analysis is suspect because the losses in loss trend Exhibit 10 do not match the losses reported in Exhibit 3 Summary of Premiums, Losses and ALAE. The losses in Exhibit 10 are closest to the actual incurred losses and LAE in the rate level indication exhibit. Consequently, it appears that the trend data is based on incurred losses and claims as opposed to paid losses and claims. Trend analysis based on incurred losses can be easily skewed by loss development factors.

The loss trend analysis highlights the weakness of the loss trend data utilized by Praetorian – data only through second quarter 2011 when more current data are available and combined data for Balboa IC and QBE Specialty instead of separate data and trend analyses.

Table 10
Exponential Trend Analysis Results, Praetorian Data from Filing Exhibit 10

					Exclude	**Last**	**Point**
Points	Severity	Freq	Pure Prem		Severity	Freq	Pure Prem
17	-17.1%	22.7%	1.7%				
16	-17.2%	25.3%	3.7%		-18.3%	21.4%	-0.8%
15	-17.3%	27.9%	5.8%		-18.6%	24.2%	1.1%
14	-17.0%	28.3%	6.5%		-18.9%	27.0%	3.0%
13	-16.2%	27.4%	6.7%		-18.8%	27.3%	3.3%
12	-16.2%	25.8%	5.5%		-18.3%	26.1%	3.1%
11	-18.4%	24.4%	1.5%		-18.6%	24.0%	0.9%
10	-19.9%	25.8%	0.8%		-21.7%	21.8%	-4.6%
9	-18.3%	26.6%	3.4%		-24.3%	22.9%	-7.0%
8	-15.6%	28.7%	8.6%		-23.6%	23.1%	-6.0%
7	-11.3%	35.8%	20.4%		-22.0%	24.6%	-2.8%
6	-1.8%	40.1%	37.5%		-19.0%	32.7%	7.5%
5	5.3%	46.3%	54.0%		**-9.9%**	**37.5%**	**23.9%**
4	12.9%	51.6%	71.2%		-4.2%	45.9%	39.7%

7.9 REO vs. non-REO

Real-Estate Owned (REO) is property that has been foreclosed and is now owned by the lender/investor. LPI premiums for REO properties cannot be passed on to the borrower because there is no longer a mortgage or a borrower involved. LPI premiums are paid by the servicer and passed through to the lender/investor.

It is logical that there is different loss experience for REO and non-REO properties. REO properties are more likely to be vacant and more likely to be in neighborhoods with other foreclosed properties. Earlier Balboa filings partially recognized this issue by having a rating factor for type of occupancy with significantly higher rates for vacant properties. Prior to 2010, the rate for vacant properties was 3.05 times the rate of owner-occupied properties. In 2001, the vacant occupancy rate became 1.54 times the rate of owner-occupied properties. The Praetorian filing eliminates this rating factor.

The analysis of loss experience should be performed separately for REO and non-REO properties because the loss experience of REO properties is likely to be worse than that of non-REO properties. There should be different LPI rates for REO and non-REO properties, so borrowers in non-REO properties are not charged excessive rates to subsidize the rates of REO properties.

7.10 Scheduled Rating

Scheduled Rating is a mechanism for the insurer to modify the base rates – and, consequently, premiums charged – by up to + / - 25% based on characteristics of the loan portfolio covered by the LPI. The proposed schedule rating plan includes:

- 30+ days contractual delinquency measured as a % of total active mortgage loans (+ / - 15%)
- Foreclosure loans measured as a % of total active mortgage loans (+ / - 10%)
- Named Insured choice to purchase coverage for the lesser of value of improvements for unpaid principal balance ((+ / - 10%)
- Operating Expenses Associated with Lender Placed Program (+ / - 15%)
- Loss History for Hazard Insurance Protection (+ / - 15%)
- Concentration of exposures in high risk (catastrophe prone) areas (+ / - 15%)
- Average Property Values (+ / - 15%)

Scheduled Rating should not be permitted or approved because it allows the insurer to arbitrarily change the rate. For “risk characteristics” that are objectively measured – delinquent loans, foreclosure loans, basis for coverage – a rating factor should be introduced if there is an objective relationship to risk of loss. In earlier filings, Balboa had a rating factor for loans in foreclosure.

Scheduled rating based on average property values and concentration of risk in catastrophe prone areas is inappropriate because those characteristics are already captured in proposed rating factors. The filing proposes a complex rating factor for amount of coverage and includes rating territories with extremely high relativities for cat prone territories.

Scheduled rating based on operating expenses is inappropriate because it is arbitrary and because operating expenses for LPI – as opposed to insurance tracking – are minimal. Given that operating expenses for LPI should be in the range of 5%, it is unreasonable to include a provision to change rates up to + / - 15% based on a subjective evaluation of operating expenses associated with a particular servicer. In addition, this factor is particularly unreasonable because affiliates of Praetorian are likely the contractors selected by the mortgage servicers to perform the insurance tracking and related services. In essence, scheduled rating could be used to reward servicers who select QBE/Balboa for non-LPI mortgage servicing activities.

Finally, scheduled rating for loss history is inappropriate for LPI because there is no reasonable opportunity for mortgage servicers to engage in LPI loss mitigation. Unlike insureds in other lines of insurance subject to scheduled rating who can employ loss mitigation strategies to reduce losses, mortgage servicers cannot and do not employ loss mitigation strategies for LPI. Properties insured are only those without sufficient evidence of insurance; the mortgage servicer identifies the properties to be insured under the LPI policy, but does not select the properties to be insured.

7.11 Age of Home Rating Factor

The age of home rating factor has a massive impact on premium. The relativities are 0.683 for homes zero to 14 years old, 1.051 for homes 15 years and older and 1.000 for "not supplied." For properties older than 14 years, the LPI premium is 54% higher than homes 14 years or younger. The age of home factors are the same for non-hurricane and hurricane perils.
It seems unlikely that the age of home factor is the same for non-hurricane and hurricane perils. Exhibit 29D shows relativities of 0.389 and 1.000 for homes 14 years and older and homes 15 years and older, respectively for hurricane pure premium. This is inconsistent with the filed age of home relativities.

Further, it is unclear if the age of home analysis was performed on countrywide for Florida-specific data. The preliminary one-way analysis in Exhibit 28E shows a much higher clam frequency for older homes, but a slightly lower claim severity.

8. Rates Relative to Voluntary Market / Citizens or Assurant

In a prior filing, Balboa rates were determined by comparison to Assurant and Citizens. There is no valid reason why LPI rates must be more than voluntary homeowners rates. Even if we assume that LPI claims are more frequent than homeowners claims, the lesser coverage and higher reasonable loss ratios for LPI than for homeowners could produce a lower LPI premium than homeowners premium for the same property. Table 11 starts with a homeowners premium of $1X. With an expected loss ratio of 65%, the expected claims on this coverage are 0.65X. If we assume that LPI claims are 1.6 times more frequent than homeowners claims and that the lesser LPI coverage is 80% of homeowners coverage, the expected LPI claims on this property are .65X * 1..6* 0.8 which equals 0.83X. With an expected loss ratio of 85%, the indicated premium for this property is 0.98X or slightly less than the homeowners premium for the property.

Table 11
LPI versus Homeowners Premium for Same Property

1	Homeowners Premium	1X
2	Expected HO Loss Ratio	0.65
3	Expected HO Claims (2 * 3)	0.65X
4	LPI Coverage / HO Coverage	80%
5	Higher LPI Pure Premium	160%
6	LPI Expected Claims (3 * 4 * 5)	0.83X
7	Expected LPI Loss Ratio	85%
8	LPI Premium (6 / 7)	0.98X