Comments of

the Center for Economic Justice,
the Consumer Federation of America,
Greater New Orleans Fair Housing Action Center,
the National Association of Consumer Advocates,
the National Consumer Law Center, on behalf of our low-income clients,
and
the National Fair Housing Alliance.

on

Joint Notice of Proposed Rulemaking regarding Loans in Areas Having Special Flood Hazards

Docket No. OCC-2013-0015, Federal Reserve System Docket No. R-1462, FDIC RIN 3064-AE03, FCA RIN 3052-AC93, NCUA RIN 3133-AE18

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I. INTRODUCTION

Thank you for the opportunity to submit comments on the proposed rulemaking regarding flood insurance.[1] These comments are submitted by the Center for Economic Justice,[2] the Consumer Federation of America,[3] Greater New Orleans Fair Housing Action Center,[4] the National Association of Consumer Advocates,[5] the National Consumer Law Center[6] on behalf of our low-income clients, and the National Fair Housing Alliance.[7]

We appreciate the Agencies' approach to private flood insurance, and support the three-pronged definition set out in the proposed rules. But we recommend limiting private flood insurance to admitted insurers. The general approach under the escrow rules seems sensible to us, but we ask the Agencies to require escrow of flood insurance for all property secured by residential real estate, regardless of how the loan's purpose is characterized. We also urge the Agencies to consider tracking more closely the CFPB's small servicer exemption: consistency in the application of rules means a great deal. We appreciate the Agencies' limitation of the small servicer exception to those cases where the servicers are not otherwise required by law to escrow or do not have a policy or practice of escrowing, but urge greater clarification of these standards.

We are gravely concerned with the proposals regarding force-placed flood insurance. Force-placed insurance of all kinds has long been a locus of abuse for consumers, with inferior products,

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[1] These comments were written by Birny Birnbaum (CEJ), Andrew Pizor (NCLC), and Diane E. Thompson (NCLC).

[2] The Center for Economic Justice is a non-profit organization that works to increase the availability, affordability and accessibility of insurance, credit, utilities, and other economic goods and services for low-income and minority consumers.

[3] The Consumer Federation of America is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.

[4] The Greater New Orleans Fair Housing Action Center ("GNOFHAC ") is a private, non-profit civil rights organization dedicated to eradicating housing discrimination throughout the greater New Orleans area through education, investigation, and enforcement activities. GNOFHAC promotes fair competition throughout the housing marketplace-rental, sales, lending, and insurance. GNOFHAC is dedicated to fighting housing discrimination not only because it is illegal, but also because it is a divisive force that perpetuates poverty, segregation, ignorance, fear, and hatred. As the only fair housing center serving Southeast Louisiana, GNOFHAC is well versed in the many flood insurance issues facing its clients and greater community.

[5] The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[6] Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Truth in Lending, Mortgage Lending, and Foreclosures.

[7] National Fair Housing Alliance (NFHA) (www.nationalfairhousing.org) – Founded in 1988, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights groups, and individuals from 37 states and the District of Columbia. Headquartered in Washington, DC, NFHA, through comprehensive education, advocacy and enforcement programs, provides equal access to housing for millions of people.

significant overpricing, and rampant collusion between servicers and insurers. Force-placed flood insurance has pushed families into foreclosure. The Agencies must do more to rein in abuses in the use of force-placed flood insurance by servicers.

II. The Private Flood Insurance Definition Is Sensible but Should Be Clarified

The Agencies propose three basic requirements for private residential flood insurance: the insurer must be licensed; the coverage must be at least as broad as coverage provided under the National Flood Insurance Program ("NFIP"); and it must be a dual-interest policy, with notice of the cancellation provided to both the homeowner and the lender. These are sensible minimum conditions for private flood insurance. But we encourage the Agencies to clarify the licensing requirement. There is no regulation of policy forms or rates when the policies are sold by surplus lines insurers. Therefore, the rule should require that private flood insurance be offered by *admitted* insurers. The Agencies should not relax the rules further in an attempt to encourage private flood insurance. Private flood insurance that does not meet these minimum standards is likely to lead to abuse of homeowners.

III. The Escrow Rules Would Benefit from Further Refinement

Escrow of flood insurance premiums is important because it smooths out payments over time, helps insulate consumers from payment shock, and provides greater assurance to servicers that the flood insurance payments are made on time. Homeowners without escrow may not realize the true cost of the insurance or experience difficulty making the payments when they come due. Homeowners without escrow are also more subject to the risk of incurred costs through force-placed insurance. Exceptions to the rule should be narrowly drawn.

The Agencies' proposals regarding escrow are a good start. But, we urge the Agencies to remove the exemption for commercial lending secured by a residence, standardize the small servicer definitions, and provide greater clarity on when otherwise exempted small servicers are required to escrow.

A. Escrow Rules Should Provide for Escrow on All Loans Secured by Residential Property

The Agencies propose to exclude from the escrow requirements non-consumer loans secured by residential real property. We oppose this proposal and urge the Agencies to require escrow of flood insurance premiums for all loans, whether consumer or commercial, that are secured by residential real property.

The bright line rule we propose would reduce litigation risk and ease consumer understanding. The line between commercial and consumer credit is often hard to distinguish, particularly for agricultural credit. Even after fifty years, there is still no bright line rule for when the

Truth in Lending Act's exemption for business, commercial, or agricultural purpose credit applies. Both homeowners and lenders would benefit from a clear rule that is amenable to consistent application. Homeowners who put their house on the line should have the benefit of automatically escrowed flood insurance premiums, whether 51% or 49% of the loan proceeds are used for household purposes, however household purposes are defined.

Self-employed homeowners are unlikely to distinguish clearly between commercial and consumer loan purposes, and may not understand that a refinance of a consumer loan into a commercial loan means that their flood insurance will no longer be escrowed. Without a bright line rule, some consumers are likely to be surprised when the flood insurance bill comes due and may have trouble coming up with the lump sum needed to pay the premium and keep the insurance in force.

B. THE SMALL SERVICER DEFINITION SHOULD TRACK THE CFPB'S DEFINITION

We are in the midst of wide-spread changes to the rules for mortgage servicing. These changes, from the CFPB and the banking Agencies, affect the ground rules for both servicers and homeowners. The Agencies should do what they can to ease the transition to the new rules. For both servicers and homeowners, as well as compliance officers and bank supervisors, uniform definitions simplify compliance and understanding.

We urge the Agencies to use the same definition of small servicer here as used by the CFPB for its rulemaking under the Real Estate Settlement & Procedures Act (RESPA) and the Truth in Lending Act.. The CFPB defines a small servicer as one who services 5,000 or fewer mortgage loans, for all of which it or an affiliate is the creditor or assignee. This may make more sense as a basis for a small-servicer exception to the flood-insurance rules because it references the volume of servicing, rather than the entity's total assets, which may or may not be in servicing. It also requires entities who service loans for another, and thus make servicing a central part of their business model, to comply with the national servicing standards. The Agencies should follow the same logic in the flood-insurance escrow requirements.

C. SERVICERS WHO ESCROW LOANS SHOULD BE REQUIRED TO ESCROW FOR FLOOD INSURANCE, EVEN IF THEY QUALIFY AS SMALL SERVICERS

The Agencies propose to limit the reach of the small-servicer exception by requiring servicers to escrow if they are otherwise required to escrow or have a policy of "consistently and uniformly" escrowing other costs, such as hazard insurance premiums or taxes. These are sensible exceptions to the small servicer definition: if a servicer is already escrowing, there is no good reason to excuse it from escrowing flood insurance, and differential treatment of hazard insurance and flood insurance premiums, with the one escrowed and the other not, is likely to lead to confusion among borrowers.

The Agencies should narrow the exception further, however. Under the proposal, small servicers would be required to escrow flood insurance if "Federal or State law" required escrow for "the entire term of a loan secured by residential improved real estate or a mobile home." But if escrow is required for any period, escrow of flood insurance should also be required for that period. For example, the higher-priced mortgage rules promulgated by the Federal Reserve Board require that escrow be established for the life of the loan, but may be cancelled by the consumer after five years. The Agencies should make clear that flood insurance must be escrowed for as long as the escrow account is maintained by the consumer under the higher priced mortgage rules, whether the minimum of five years or the entire life of the loan or some intermediate term. If the servicer is maintaining an escrow account for that loan, the servicer should also escrow the flood insurance, even if the consumer is free to cancel that escrow arrangement at some point in the future.

Similarly, the Agencies' proposed rules require even small servicers to escrow flood insurance premiums if they have "a policy of consistently and uniformly requiring" taxes and insurance to be escrowed. Is that one percent of the servicers' loans or ten percent? Or must the servicer maintain escrows for all but one of its residential loans before the Agencies will require escrow on that remaining loan? Both servicers and homeowners would be helped by a rule that spelled out what it means to "consistently and uniformly" require escrows.

At a minimum, the Agencies' rules should require that, if an escrow of any kind is maintained on a given residential loan, flood insurance premiums should also be escrowed for that loan. If there is an escrow account on that consumer's loan, regardless of whether the servicer escrows other loans, or is required to escrow other loans, the servicer should escrow flood insurance.

The Agencies should also consider how the CFPB handled a similar conundrum. Under the higher-priced mortgage rules, small servicers must escrow if the servicer escrows on any residential loan it services. This rule provides clarity beyond the Agencies' proposal; protects servicers who do not escrow from taking on new and burdensome obligations; and ensures uniformity of practices within small servicers. Once servicers voluntarily take on the obligation of escrowing taxes and insurance, there is no rational basis for permitting servicers to choose which loans they will escrow for which insurance. The costs and expense of escrowing are largely those involved in setting up systems to track and process payments; the costs do not increase significantly on a per loan basis.

IV. More Protections Must Be Provided for Force-placed Flood Insurance

A. Overview

Flood insurance is required by law for properties located in a flood zone. Federally-regulated lending institutions may not make, increase, extend, or renew any loan secured by improved real estate in a Special Flood Hazard Area ("SFHA"), as determined by the Federal

Emergency Management Agency ("FEMA"), unless an improved property serving as collateral for the loan is covered by a minimum amount of flood insurance,[8] as defined by statute.[9]

The purchase of flood insurance is not discretionary consumers in SFHAs. Consumers are unlikely to independently shop for it outside of the mortgage transaction. And homeowners have very little control over the contours of their flood insurance policies.

While homeowners are in the first instance liable for the excessive charges resulting from force-placed flood insurance, investors often end up bearing the costs. While the servicer is required to advance the costs of any force-placed flood insurance premium that the borrower does not pay, the servicer is entitled to recover those funds off the top in a foreclosure sale, before the mortgage holder recovers its investment. This often means that Fannie Mae and Freddie Mac—and U.S. taxpayers—reimburse mortgage servicers for the cost of force-placed flood insurance. Servicers therefore have no incentive to keep the cost of force-placed flood insurance down, and many incentives to maximize it.

The changes mandated by the Biggert-Waters Flood Insurance Reform Act of 2013 come in the midst of widespread litigation and controversy over how mortgage servicers have handled their responsibilities under the National Flood Insurance Act. Homeowners have accused servicers of requiring more insurance than necessary, unnecessarily force- placing insurance, and accepting kickbacks that inflate the cost of force-placed flood insurance. Insurers have also been accused of charging force-placed flood insurance premiums far in excess of what would be justified by the risk of loss.

The proposed regulations to implement Biggert-Waters leave substantial gaps that will allow abuses of force-placed flood insurance to persist. As described in further detail below, we urge the Agencies to adopt additional provisions that will:

- Reduce the incidence of force-placed flood insurance.
- Prevent kickbacks and other practices that unreasonably inflate the cost of force-placed insurance and encourage excessive use.
- Limit retroactive billing to a reasonable time period.
- Prohibit servicers from requiring voluntary flood coverage that exceeds the lesser of the unpaid principal balance or the replacement cost of the home.
- Require servicers force-placing insurance to establish the amount of coverage at the borrower's last known flood coverage amount.
- Where the last known coverage amount is unknown, prohibit the servicer from force-placing more coverage than the lesser of the unpaid principal balance or replacement cost.

[8] 42 U.S.C. § 4012a(b).
[9] 42 U.S.C. § 4012a(a).

- Require additional notice of force-placed flood insurance consistent with the CFPB's new rule for hazard insurance.

These provisions are necessary to protect consumers from a dysfunctional insurance market and collusion between servicers and insurers. These rules will also enhance the safety and soundness of regulated lending institutions by protecting them from unreasonable expenses, litigation risk, and the reputational harm that abusive force-placed insurance practices can pose.

B. THE AGENCIES SHOULD BUILD ON CURRENT MARKET PRACTICES TO PROVIDE GREATER PROTECTIONS FOR HOMEOWNERS

Current market practices offer room to provide homeowners with greater protection from abuse, without jeopardizing the interests of either servicers or lenders. Existing flood insurance polices provide for notice to both lenders and homeowners in advance of policy cancellation. Further protection to lenders is offered by the automatic coverage afforded under most force-placed insurance polices. Although the NFIP offers a force-placed insurance product, called the Mortgage Portfolio Protection Program,[10] servicers rarely, if ever, use it because it does not allow for automatic coverage.

Servicers who must refund force-placed insurance premiums to homeowners will usually already have received the refund from the force-placed insurance company; refunds to servicers are automatically advanced under current force-placed flood insurance policies once the borrower provides documentation of coverage. The Agencies could build on these existing practices to improve notice to borrowers, minimize retroactive billing, and speed refunds to borrowers, without subjecting servicers or investors to greater risk or costs. The Agencies should also encourage the use of blanket policies, which are currently underutilized and would reduce the costs of continuous coverage and avoid the need for force-placed insurance.

Most lenders are covered by loss endorsements under flood insurance policies and are entitled to notice before the policy is canceled. Such endorsements generally provide that the policy will remain in effect for a period of time after the lender receives the notice, regardless of the reason for cancellation. This gives lenders, and their agents—the servicers—time to take appropriate action before the policy is canceled. Servicers should be required to use this lead time to warn homeowners of the need to maintain coverage before the policy actually lapses, in order to avoid force-placed insurance and minimize the need for retroactive billing.

(As discussed below in section IV.D.1 below, where the policy is at risk of cancellation for non-payment and the homeowner fails to maintain it, the servicer should also be required to advance the premium rather than letting the policy lapse. The advance notice afforded servicers under the loss endorsement clauses provides ample time for servicers to do so without incurring additional costs).

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[10] http://www.fema.gov/media-library-data/20130726-1912-25045-6307/10_mppp_may2013.pdf

For further protection, most servicers purchase a master policy that covers all loans in the portfolio and provides coverage automatically, as needed when voluntary flood insurance policies lapse. These policies cover 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. This type of policy (known as a "force-placed insurance-flood," or "FPI-F" 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. The FPI-F policy provides coverage, for example, if the borrower's voluntary flood insurance policy is canceled or lapses because of non-payment of the premium. The FPI-F policy also covers instances when the borrower's coverage is less than that required by the servicer. The FPI-F policy provides coverage whenever the borrower's required insurance fails to remain in-force—even if the servicer or its vendor does not discover this failure of insurance coverage for days or weeks after the borrower's policy coverage has ended.

When a lapse in coverage is discovered on a property in the mortgage loan portfolio, the FPI-F insurer is instructed to issue a certificate of 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 insurance has been issued and the charges for the FPI-F have been added to the obligations that will be paid from the borrower's escrow account. The correspondence informs the borrower that the FPI-F 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 FPI-F insurance. Servicers will often outsource to the FPI-F vendor the role of billing the borrowers for the FPI-F premiums, as well as providing the borrowers with basic information about the existence of the force-placed policy.

The FPI-F group policy covers all properties in the servicer's loan portfolio and provides coverage as needed. Thus, servicers and investors bear little to no risk of having a property remain uninsured, even if a borrower does not maintain or renew coverage promptly. Servicers do not need any lead or processing time in order to find force-placed insurance; the coverage arises automatically. Servicers can focus their efforts on working with homeowners without fear that the property will be left uninsured. Moreover, under the typical FPI-F program, the servicers are automatically reimbursed for any force-placed insurance premiums the servicer happens to pay if and when a borrower produces evidence of existing coverage. If a servicer purchases force-placed insurance and later discovers that the borrower was insured all along, the servicer will get its money back. It has nothing to lose by crediting promptly the borrower's account for the unnecessary force-placed insurance charge.

C. FORCE-PLACED INSURANCE IS OVERPRICED DUE TO REVERSE COMPETITION

Mortgage servicers use FPI not only for flood coverage but also for hazard coverage, when a borrower's voluntary homeowners insurance lapses. Insurers and banks have built a network of relationships and financial arrangements that have driven premium rates on FPI to inappropriately high levels ultimately paid for by consumers and investors.[11] Since 2007, the cost of FPI has quadrupled, while loss ratios continue to be far below that of voluntary insurance.[12]

The available data on force-placed insurance, from the Credit Insurance Experience Exhibit (CIEE) that servicers file with state insurance regulators along with their Statutory Annual Financial Statements,[13] does not break out force-placed flood insurance separately from force-placed hazard insurance, but the products and industry practices are sufficiently similar to be generalizable.

The CIEE data show huge increases in gross written premium, net written premium (NWP) and earned premium (EP)[14] from 2004 through 2011 and continued high premium levels in 2012. The data also show that the ratio of claims paid to premiums collected by FPI insurers has been very low—averaging about 25%.[15] In short, the data shows FPI has been widely used in recent years and is very profitable.

FPI Nationwide Experience, 2004-2012

Year	Gross Written Premium	Net Written Premium	Earned Premium		Paid Loss Ratio	Incurred Loss Ratio
2004	$1,485	$796	$807		33.5%	33.1%
2005	$1,832	$919	$850		40.4%	53.5%
2006	$2,163	$1,074	$988		29.5%	29.0%

[11] April 5, 2013 letter from Superintendent Benjamin Lawsky to other state insurance regulators at http://www.dfs.ny.gov/about/press2013/Force-placed_Letter.pdf

[12] Birny Birnbaum. Statement to Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Economic Policy. Implementation of the Biggert-Waters Flood Insurance Act of 2012: One Year After Enactment, Hearing Sept. 18, 2013. Available at: www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=f7c2976a-ddaa-4b1a-a4a8-8ddc2e7664da. Much of the technical discussion in these comments is based on, or directly quoted from Mr. Birnbaum's testimony.

[13] While the data reflect the experience of the largest writers of the market, some insurers writing FPI have failed to submit required CIEE reports. The CIEE data is estimated to reflect about 90% to 95% of the total FPI market.

[14] Gross written premium is the total amount of premium charged to servicer policyholders on coverage issued in a particular year before any refunds. Net written premium is the total amount of premium charged to servicer policyholders on coverage issued in a particular year after refunds for cancellations. Earned premium is the premium associated with exposures during a particular year. For example, if coverage was issued on July 1 with an annual premium charge of $5,000 and assuming the coverage was not canceled and refunded, the gross and net written premium would be $5,000. The earned premium would be six months of the annual policy – from July through December of the year – for a total of $2,500 in the year the coverage was issued and $2,500 in the following year.

[15] Paid loss ratio equals dollars of claims paid in a particular year divided by net written premiums in that year. Earned loss ratio equals incurred losses in a particular year divided by earned premiums in that year. Incurred losses are the insurer's estimate of the ultimate amount of claim dollars that will be paid on coverages issued – exposures – in that year. Paid loss ratio is a cash flow measure, while incurred loss ratio is generally a better measure to evaluate the reasonableness of rates.

Year	Gross Written Premium	Net Written Premium	Earned Premium		Paid Loss Ratio	Incurred Loss Ratio
2007	$3,058	$1,647	$1,402		16.0%	20.5%
2008	$4,000	$2,209	$1,999		20.1%	23.3%
2009	$5,181	$3,049	$2,641		16.0%	20.7%
2010	$5,915	$3,223	$3,248		15.7%	17.3%
2011	$5,692	$3,450	$3,256		22.5%	24.7%
2012	$5,115	$2,870	$3,187		30.5%	30.8%
2004 to 2012	$34,442	$19,238	$18,378		22.4%	25.3%

At least 90% of the FPI premium is written by just two insurers—Assurant and QBE. Both companies provide FPI and insurance tracking services to the largest mortgage servicers. Assurant alone provides tracking and FPI for about 75% of all outstanding mortgages.[16] The remaining FPI premium is written primarily through managing general agents who administer FPI and insurance tracking to the remaining thousands of community banks, credit unions and small lender/servicers.

FPI premium charges are significantly higher than voluntary insurance premium charges for the same property. An investigation by the New York Department of Financial Services ("NYDFS") found that the premiums charged to homeowners for force-placed insurance are two to ten times higher than premiums for voluntary insurance, even though the scope of the coverage is more limited.[17]

Insurers selling FPI argue that the higher premium charges are justified by various factors, including:

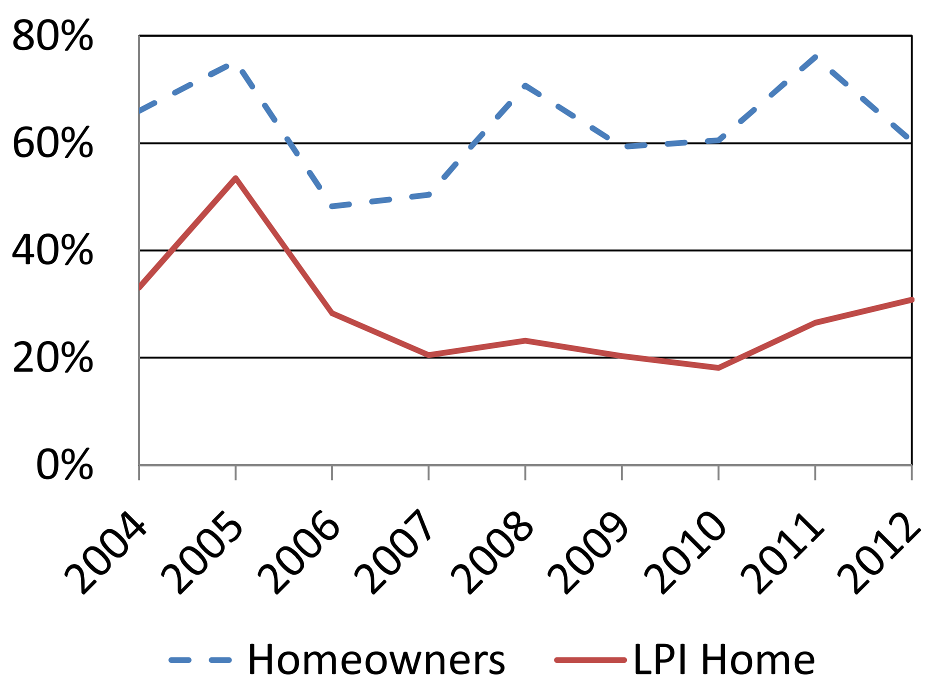
- Lack of individual underwriting means FPI is much riskier than homeowners insurance for which the voluntary insurer can underwrite and reject individual properties.
- FPI exposures are concentrated in catastrophe-prone areas and, consequently, more susceptible to catastrophic losses.

[16] Assurant Earnings Call Transcript Q3 2013
[17] April 5, 2013 letter from Superintendent Benjamin Lawsky to other state insurance regulators at http://www.dfs.ny.gov/about/press2013/Force-placed_Letter.pdf

- FPI expenses are greater than expenses for homeowners insurance because of the special activities associated with administering an FPI policy.
- FPI expenses are greater than expenses for homeowners because many or most FPI coverages are canceled before the full term of coverage.

Based on the industry explanation for higher FPI rates, FPI loss ratios should be higher than homeowners' voluntary insurance loss ratios, due to the greater risk associated with FPI. Moreover, if, in fact, FPI is more susceptible to catastrophic events, there should be greater volatility in FPI loss ratios than homeowners' loss ratios. Instead, the loss ratio results from 2004 through 2012 show FPI loss ratios have been far less than ratios for homeowners' insurance.[18]

Loss Ratios for Homeowners and FPI, All States, 2004-2012



Looking at the data from Florida, a state with a high incidence of catastrophic loss, confirms that FPI loss ratios are both lower and less volatile than the loss ratios for voluntary insurance. While the homeowners' loss ratio jumped in 2011 because of major catastrophe events, the FPI loss ratio remained low. And in 2012, the year of Superstorm Sandy, even though flood damage was covered by FPI but not by homeowners' insurance, the FPI loss ratio remained far below the homeowners loss ratio.

[18] Data Sources: LPI Home, NAIC Credit Insurance Experience Exhibit data compiled by Birnbaum. Homeowners 2004-2011, NAIC Report on Profitability by State by Line in 2011; Homeowners 2012, compilation by Birny Birnbaum (CEJ) of State Page data provided by NAIC. The NAIC does not endorse any calculations performed on data it provides.

Florida Homeowners' and FPI Loss Ratios

	Florida Voluntary Homeowners	Florida FPI
2004	303.0%	75.2%
2005	153.6%	102.5%
2006	32.6%	29.6%
2007	25.6%	11.4%
2008	33.9%	10.6%
2009	38.4%	11.7%
2010	38.1%	7.2%
2011	35.9%	9.9%
2012	31.6%	13.3%
2004-2012	61.4%	13.6%

An investigation by NYDFS showed similar results, with the loss ratios for FPI seldom exceeding 25%, while voluntary insurance had loss ratios between 55% and 58%.[19]

With average FPI premiums at least twice that of average homeowners insurance, calculating expenses on a percentage-of-premium basis should mean twice as many expense dollars, if the insurer's arguments are correct. But the insurer's expenses on FPI and voluntary polies are not comparable. FPI does not have some of the operational costs associated with voluntary insurance because there is no individual property underwriting. FPI premiums do not include the cost of property inspections, credit histories, CLUE (claims history reports), interviewing homeowners for underwriting, or other acquisition expenses common in voluntary policies.

The high profit margin for FPI (as indicated by the loss ratio) is one result of widespread reverse competition in the FPI market. Instead of competing for individual consumers, insurers

[19] Birny Birnbaum. Statement to Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Economic Policy. Implementation of the Biggert-Waters Flood Insurance Act of 2012: One Year After Enactment, Hearing Sept. 18, 2013. Available at: www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=f7c2976a-ddaa-4b1a-a4a8-8ddc2e7664da (citing April 5, 2013 letter from Superintendent Benjamin Lawsky to other state insurance regulators at http://www.dfs.ny.gov/about/press2013/Force-placed_Letter.pdf).

compete for the entities with the market power to steer business to the insurer. Insurers compete for the servicer's business by giving the servicer financial benefits, such as:

- Free tracking/servicing activities unrelated to FPI;
- FPI commissions;
- Captive reinsurance administrative costs; and
- Affiliate transactions at above-market prices

The insurers then recoup the cost of those benefits by inflating the cost of FPI premiums. The servicer and the insurer benefit handsomely from this practice.

In contrast, the borrower and the mortgage holder pay the costs without any ability to control them. The borrowers exert no market power in the setting of these rates. In addition, there is no downward market pressure on rates. As a result, the vendors offering FPI do not compete on the basis of price, but on the basis of services and compensation provided to the servicer or its affiliates.

A 2012 Fannie Mae request for proposals describes the problem:

> 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). . . . . . . [M]uch 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.[20]

The commissions insurers pay to servicer-affiliated insurance producers are not justified by any service provided by the producers. Instead, they are little more than a thinly veiled kickback to the servicer for placing the FPI. Many of the rationales cited by industry executives for these kickbacks—such as soliciting FPI providers or reviewing form documents—are either associated with no work at all or are activities for which the servicer is already compensated. Nor can the excuse that commissions are a cost of doing business justify an otherwise abusive and illegal business practice.

[20] Fannie Mae, Request for Proposal for Lender Placed Insurance, Insurance Tracking, and Voluntary Insurance Lettering Program at 2 (Mar. 6, 2012). (Emphasis added.)

Sometimes these kickbacks are processed through captive reinsurance arrangements. Captive reinsurance arrangements—in which the FPI insurer reinsures a portion of FPI business with a reinsurance company owned or affiliated with the servicer—are profit-sharing mechanisms. These arrangements serve no substantive risk management purpose and provide no value to the homeowners forced to pay inflated rates. Captive reinsurance programs put the servicer's interests squarely at odds with the borrower's interests.

D. RECOMMENDATIONS FOR IMPROVING THE PROPOSED FORCE-PLACED FLOOD INSURANCE REGULATIONS

1. REQUIRE SERVICERS TO ADVANCE VOLUNTARY INSURANCE PREMIUMS RATHER THAN LETTING THE BORROWER'S POLICY LAPSE FOR NON-PAYMENT

Under the standard mortgagee endorsement for most flood and hazard insurance policies, the insurer notifies the borrower's loan servicer when the policy is at risk of cancellation for non-payment. This gives the servicer time to contact the borrower and remind her of the contractual duty to maintain insurance coverage on the borrower's home. If the borrower still fails to pay the insurance premium or purchase other coverage, current guidelines allow the servicer to sit by and let the insurer cancel the policy. The servicer may then replace the borrower's policy with a much more expensive FPI-F policy, advancing the cost and billing the borrower.

Instead, the servicer should be required to advance the funds necessary to keep the borrower's policy in force. This would pose no additional burden on the servicer because the servicer already advances the cost of the FPI-F and already tracks the status of the borrower's insurance. The important difference is that keeping the borrower's policy in effect would protect the borrower and investor from the extra cost of FPI-F.

This is a common sense solution to maintaining continuous coverage at an affordable price. The servicer is the investor's agent and has a duty to minimize costs. The borrower and investor are the two parties that benefit most from flood insurance coverage. And there is no valid reason for the borrower or the investor to pay extra to line the servicer and insurer's pockets.

Where the servicer is a federally regulated banking institution, this recommendation will also promote safety and soundness. Funds advanced for insurance, whether a voluntary policy or FPI-F, create a financial liability for the servicer. If the borrower cannot afford to bring the loan current, that liability will typically remain outstanding until the foreclosure process is complete. Advancing funds for a voluntary policy is less expensive for a bank than for FPI-F and is more responsible from the perspective of safety and soundness. The same analysis holds where a regulated institution owns the mortgage.

The CFPB has already adopted such a rule for hazard insurance.[21] We urge the Agencies to adopt a similar requirement for flood insurance. In addition to the benefit for consumers and investors, applying the same rule to flood insurance will also simplify compliance for servicers and increase understanding by homeowners by reducing the number of differences between the treatment of flood and hazard insurance.

2. PREVENT KICKBACKS AND OTHER PRACTICES THAT UNREASONABLY INFLATE THE COST OF FORCE-PLACED INSURANCE AND ENCOURAGE EXCESSIVE USE

Even if the Agencies adopt our first recommendation, FPI-F will still sometimes be necessary. For example, a homeowner who is not in a flood zone when a mortgage loan is extended will not be required to obtain flood insurance. But flood zones change. If it is later determined that the home is in a flood zone, and the homeowner does not respond by obtaining flood insurance, the servicer will have to force place the insurance.[22]

The Agencies should require that, when flood insurance is force-placed, its costs should be reasonable. Inflated costs can push homeowners into foreclosure unnecessarily as they did for the Davis family in Alabama:

Reginald Davis purchased a home in Alabama in 2008. At the time he purchased it, he was not required to have flood insurance. In 2012, however, Bank of America notified him that his home was in a flood zone and insisted that he obtain flood insurance. Mr. Davis disputed that his home was in a flood zone and sent appropriate documentation to the bank. While his dispute was in process, however, Bank of America force placed flood insurance on Mr. Davis, more than doubling his monthly mortgage payments (from $1,521.41 to $3,427.89). Unsurprisingly, Mr. Davis was not able to pay double his monthly mortgage payment, and found himself in foreclosure.[23]

The Agencies should prohibit practices that inflate the cost of FPI-F premiums. Specifically, the Agencies should prohibit servicers from:

- purchasing flood insurance from an FPI-F insurer affiliated with the servicer;
- accepting or requesting a commission related to FPI-F or otherwise based on underwriting profitability or loss ratios;
- engaging in captive FPI-F reinsurance agreements with any FPI-F insurer that places flood insurance on properties serviced by the servicer;
- accepting or requesting free- or below-cost outsourced services from insurers; or

[21] 12 C.F.R. § 1024.17(k)(2) (requiring servicers to pay escrowed items if the borrower is not more than 30 days in arrears on the mortgage principal and interest payment).
[22] Other examples include where the borrower's policy is cancelled for reasons other than non-payment or where the borrower has insufficient coverage.
[23] Davis v. Bank of Am., 2013 WL 5671049 (M.D. Ala. Oct. 17, 2013).

- accepting or requesting any payments from FPI-F insurers in connection with providing insurance or related services.

These rules would prohibit servicers from having any financial interest in the placement of FPI-F, other than the coverage provided by the insurance. These rules largely mirror recent consent orders between the NYDFS and three of the largest insurers in the nation, as well as proposed New NYDFS regulations.[24] But those consent orders only apply in New York and do not affect servicers obtaining FPI-F from other companies. Fannie Mae and Freddie Mac will likely adopt provisions to reduce expenses associated with captive reinsurance, under new guidance from the Federal Housing Finance Administration.[25] But those requirements will only affect loans eligible for sale to the GSEs and will leave many sources of over-pricing unaffected. Clear, uniform, national regulations are needed.

In general, the regulations should mandate that all charges related to force-placed insurance imposed on a borrower be bona fide and reasonable. Such charges must only be for services actually performed and bear a reasonable relationship to the servicer's cost of providing the service. But the more specific prohibitions listed above create a bright-line rule that will be easy for servicers to comply with and for regulators to enforce.

3. LIMIT RETROACTIVE BILLING TO A REASONABLE TIME PERIOD

Mortgage servicers are responsible for tracking insurance coverage on the loans they service. When there is a lapse in a homeowner's insurance coverage, the servicer--typically through an insurance tracking vendor--notifies the force-placed insurer. Federal law requires federally-regulated or insured lenders and servicers to monitor loans for the continuous presence of required flood insurance on properties located in a Special Flood Hazard Area.[26] In addition, federal regulations require mortgage servicers to provide notices in specified time frames before charging for hazard FPI and prohibit placing FPI if a borrower has an escrow account on her loan and payment of premium will keep the voluntary policy in force.[27] It is the servicer's responsibility to identify lapses in insurance and notify homeowners of these lapses in a timely fashion, although the servicer often delegates these duties to a force-placed insurance vendor.

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[24] *See* Birny Birnbaum. Statement to Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Economic Policy. Implementation of the Biggert-Waters Flood Insurance Act of 2012: One Year After Enactment, Hearing Sept. 18, 2013. Available at: www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=f7c2976a-ddaa-4b1a-a4a8-8ddc2e7664da (discussing NY proposal).

[25] Press Release, Fed. Hous. Fin. Admin., FHFA Directs Fannie Mae and Freddie Mac to Restrict Lender-Placed Insurance Practices (Nov. 5, 2013), available at www.fhfa.gov/webfiles/25759/LPI_news_release_110513.pdf.

[26] 42 U.S.C. § 4012a (e)

[27] Reg. X (12 C.F.R.) §§ 1024.34, 1024.37.

Once a lapse in voluntary coverage is discovered by the servicer and FPI coverage is issued under a FPI master policy, the FPI insurer charges a premium to the servicer. The servicer, after sending required notices to affected borrower and failing to receive evidence of voluntary insurance, charges the borrower for FPI. Servicers charge borrowers for FPI at some point after the lapse in coverage, but charge for coverage beginning from the date of the lapse. Consequently, servicers retroactively charge borrowers for the coverage that was automatically in force the instant the borrower's voluntary hazard or flood insurance coverage lapsed.

Servicers and their insurance tracking vendors may not discover a lapse in coverage instantly. But they can certainly contract for advance notice of cancellation from insurers, and in fact, most lender loss endorsements require notice of cancellation to be provided to the lender in advance of cancellation. Servicers should not sit on this information, but should act promptly to notify the borrower so the borrower can reinstate lapsed coverage or obtain new coverage. When the servicer fails to notify the borrower in a timely fashion, the borrower will owe an excessive charge for retroactive premiums and it will be too late to avoid the cost by obtaining a voluntary policy.

The Leghorn family's experience illustrates the problem with retroactive billing practices.[28] On January 30, 2012, Mr. and Mrs. Leghorn were notified by their servicer that temporary FPI flood coverage had been placed for a 90-day period beginning on December 12, 2009—more than two years before the Leghorns received the notice of the force-placed flood insurance. On March 6, 2012, only slightly more than a month after the Leghorns first received notice of a problem with their insurance coverage, the servicer charged the Leghorns for FPI flood insurance coverage for the full year from December 12, 2009 to December 12, 2010. The servicer then sent a notice the next day, March 7, 2012, to the Leghorns stating that it required evidence of flood insurance for the period from December 12, 2010 through December 12, 2011. Thirty days later, on April 6, 2012, the servicer charged the Leghorns for FPI flood for the period December 12, 2010 through December 12, 2011 – almost 16 months after the lapse in coverage and almost four months after the coverage had expired. The notices were provided long after the Leghorns could have reinstated their insurance and after substantial costs had been incurred.

The servicer should be required to provide notice to the homeowner immediately upon learning of the lapse or risk of cancellation, and before the expiration of coverage, if the servicer receives such notice. Specifically, servicers should be required to send borrowers notice of the lapse in coverage within ten days of receiving notice of cancellation, and more than five business days before such cancellation. Such advance notice would allow borrowers to correct any lapse in coverage before the imposition of force-placed insurance. To the extent the loss lender endorsements do not currently provide for more than ten days of notice before cancellation, lenders should be encouraged to either provide notices of lapses in coverage more quickly than the ten days

[28] *See* complaint in Leghorn, et al v. Wells Fargo Bank, N.A., Case No. 4:13-CV-00708-JCS (N.D. Cal.).

otherwise permitted or to negotiate with insurance companies for a longer continuance of coverage between notification and cancellation.

In no event should the servicer be permitted to charge the borrower for lapsed coverage if the servicer fails to identify the lapse within sixty days. If the servicer fails to identify the lapse in coverage within this reasonable period of time, the servicer – not the borrower – should bear any retroactive charges beyond sixty days.

Retroactive charges for more than a reasonable period of time, such as sixty days, are unfair to borrowers. Lengthy retroactive charges render the notice requirements for FPI meaningless. The purpose of the notice requirement is to encourage the borrower to take action to avoid FPI. When the servicer delays notifying a borrower, it becomes impossible for the borrower to avoid the cost of FPI. Moreover, a lengthy retroactive charge means that the servicer has failed to do a reasonable job of tracking voluntary insurance coverage. Since tracking is the servicer's responsibility, it is unfair for the servicer to charge the borrower for the servicer's failure. While the servicer may argue that the borrower is at fault for failing to maintain contractually required insurance, many borrowers do not realize they need flood insurance, especially when flood maps change.

4. IMPOSE LIMITS ON HOW MUCH VOLUNTARY FLOOD COVERAGE THE SERVICER MAY REQUIRE OR FORCEPLACE AND REQUIRE THE SERVICER TO MAINTAIN THE COVERAGE LEVEL ELECTED BY A BORROWER

The agencies should take steps to protect borrowers from either excessive and unwanted flood insurance or the servicer's failure to provide adequate coverage.

- Prohibit servicers from requiring voluntary flood coverage that exceeds the lesser of the unpaid principal balance or the replacement cost of the home.
- Require servicers force-placing insurance to establish the amount of coverage at the borrower's last known flood coverage amount.
- Where the last known coverage amount is unknown, prohibit the servicer from force-placing more coverage than the lesser of the unpaid principal balance or replacement cost.

The issue of the minimum amount of flood insurance coverage a servicer may require is difficult because of problems with the implementation of the Biggert-Waters Act rate provisions. Representative Waters herself has declared the rate provisions of her legislation offensive as tens of thousands of borrowers are facing unaffordable rate hikes with no meaningful options--if the borrower fails to pay the new massive NFIP premiums, the borrower will be force-placed expensive FPI-F. Selling the home will generally not be an option because the new buyer must pay the full actuarial rate, thereby reducing the sales price of the borrower's home dramatically. Congress has indicated its concern over the availability and affordability of flood insurance under Biggert-Waters and required FEMA to complete an affordability study by last April. But FEMA has not only failed to complete such a study documenting the impacts of Biggert-Waters rate increases, but has testified that such a study will required more funds from Congress and two to three years to complete.

Layered onto the rate-increase problems of Biggert-Waters is the structure of FPI-F markets in which servicers, who are in the position to dictate the amount of coverage, have a financial interest in the placement of FPI-F. While we believe that replacement cost is the amount of coverage generally necessary to protect the borrower's property, given the situation with Biggert-Waters, the current structure of FPI-F markets, and the fact that flood insurance requirements were established to protect lenders and the federal Agencies guarantying loans in SFHAs (rather than to protect homeowners), we urge the Agencies to prohibit servicers from force-placing more flood insurance coverage than the Last Known Flood Coverage Amount (LKCA). In the absence of LKCA, the servicer should be prohibited from requiring more than the lesser of unpaid principal balance or replacement cost. The borrower is always able to purchase more coverage if she wants, but the restrictions we set out protect borrowers in the current market for voluntary and force-placed flood insurance.

Gordon Casey's experience illustrates how servicers sometimes demand an unreasonable amount of flood insurance coverage for small mortgages. In 2011, Mr. Casey's loan was transferred to a new mortgage company. At the time, Mr. Casey's balance was only $17,000. But the new company, MidFirst, demanded that he increase his total flood insurance coverage to $237,349—the full replacement value of his house. When Mr. Casey did not do so, they force-placed the additional coverage, resulting in a substantially higher annual premium (of $1478.12). This increased premium pushed Mr. Casey into foreclosure.[29]

Homeowners should be allowed to decide for themselves how much coverage they need, and how much risk they will tolerate, as long as the amount of coverage meets the federal minimum. If the home is damaged in a flood, and the homeowner cannot afford the repairs, she may still be able to sell the land and move to a rental unit, purchase a smaller home, or move in with relatives. But in that event, the decision to move would be the consequence of the homeowner's decision and not the result of a mortgage servicer demanding more insurance coverage than it needs. Many homeowners, such as those living on a fixed income, or owners of vacation homes, may prefer to buy only the minimum coverage required. The owner of a vacation home may be willing to accept the risk of loss because the structure is not his primary residence. If a servicer requires more insurance than necessary, a homeowner who retires on a fixed-income may be forced to sell or default. This is especially the case for someone who has paid off most of the mortgage, in which case the premiums for replacement value could be substantially higher than the minimum required by the Act.

While many homeowners will want full replacement coverage (even when they are not required to have that much), forcing it on homeowners who neither need nor want it is abusive--particularly in light of the excessive cost of force-placed insurance and the perverse incentives servicers have to ratchet up the cost. Allowing servicers to require more insurance than elected by the homeowner and required under the law is an abuse that has resulted in a significant amount of litigation. Ending this abuse will protect borrowers and reduce the risk of litigation for regulated institutions servicing loans. If a servicer has a valid basis for imposing FPI-F, the servicer should be limited to imposing the same amount of coverage as the borrower had before the lapse.

Nor should the servicer be permitted to provide less than the last known coverage amount (even if the Act would permit it). Many homeowners assume that the force-placed insurance is roughly equivalent to their existing policy and may choose to let the force-placed insurance remain in force for some time while they shop for alternatives. Such homeowners should not be exposed to a total loss of their home by a servicer that force-placed less than the last known coverage amount. This lets homeowners decide how much coverage they want to pay for, subject to the statutory minimum.

5. REQUIRE ADDITIONAL NOTICE OF FORCE-PLACED FLOOD INSURANCE

The proposed regulation requires servicers to send borrowers a 45-day warning that the servicer will purchase FPI-F if the borrower does not obtain needed flood insurance coverage. We recommend adding a second 15-day reminder, as required for force-placed hazard insurance under the CFPB's rule.[30] Adding such a requirement will simplify compliance for loan servicers subject to RESPA's Regulation X and reduce borrower confusion.

A borrower who needs both types of insurance will receive a notice for each (or a combined notice) 45 days before the servicer assesses a premium for FPI. Borrowers who fail to purchase hazard insurance within 30 days will receive a follow-up warning notice, but there is no proposal to require a similar warning for flood insurance,

Many borrowers do not realize that a traditional homeowner's policy does not cover flood damage. As a result, a borrower receiving 45-days notice about both types of insurance may purchase a hazard insurance policy that does not cover floods and think that the matter is resolved. Such a borrower would then still be at risk of force-placed flood insurance but would receive no additional notice--unless the Agencies also require a 15-day notice for flood insurance.

E. AGENCY ACTION IS NECESSARY BECAUSE FORCE-PLACED FLOOD INSURANCE WILL BECOME INCREASINGLY COMMON AND OTHER PROTECTIONS ARE INSUFFICIENT

The number of FPI-F placements will increase as the Biggert-Waters Act is implemented. First, many more borrowers are now required to purchase flood insurance due to new flood maps from FEMA. With more borrowers required to purchase flood insurance will come more FPI-F

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[29] Casey v. Citibank, N.A., 915 F. Supp. 2d 255 (N.D.N.Y. 2013), *motion to certify appeal denied*, 5:12-CV-820, 2013 WL 1501008 (N.D.N.Y. Apr. 10, 2013).
[30] 12 C.F.R. § 1024.37(c), (d).

placements. Second, the NFIP rate hikes required under Biggert-Waters will raise NFIP premiums for borrowers. As premiums rise, some borrowers will become unable to maintain flood coverage, and servicers will force place insurance at even higher costs to borrowers. Third, as lenders and servicers face greater penalties from Biggert-Waters for failing to ensure required flood insurance is in place, servicers will be likely err on the side of too many FPI-F placements.

State insurance departments have failed to protect consumers from excessive rates and kickback arrangements between FPI-F insurers and mortgage servicers. In recent years, New York has been the leader in identifying and addressing FPI abuses and excessive rates. But, even the settlements between the NYDFS and FPI insurers do not cover FPI-F. While borrowers are now protected from other forms of abusive force-placed insurance under RESPA's implementing regulations, flood insurance is specifically excluded from the scope of those regulations.

Absent aggressive action by the federal Agencies, borrowers facing force-placed flood insurance will be left largely without protection.

V. CONCLUSION

We thank the Agencies for the opportunity to comment on this important rulemaking. The regulation of mortgage servicers and flood insurance is at a watershed moment. The Agencies should act to ensure the safety and soundness of the institutions they regulate and to protect consumers. Rigorous standards for private flood insurance must be maintained. Servicers should be required to provide escrow of flood insurance whenever they are escrowing hazard insurance or taxes, for the sake of simplicity and consumer protection. Escrow of flood insurance should be required on all residential mortgages. Significant additional protections against retroactive billing, placement of insufficient or excessive force-placed coverage, additional notices to align with the CFPB force-placed insurance disclosures, and mandatory advancement of escrow funds to maintain the borrowers' existing coverage rather than force placing coverage should be implemented.