Consumer Mortgage Coalition

May 28, 2013

Federal Housing Finance Agency
Office of Housing and Regulatory Policy
Constitution Center
400 Seventh Street. S.W.
Washington, D.C. 20024

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

Dear Sir or Madam:

The Consumer Mortgage Coalition ("CMC"), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments on the Federal Housing Finance Agency's ("FHFA") notice ("Notice") of an approach to address certain practices relating to lender-placed insurance ("LPI"). We appreciate the FHFA's continuing efforts to obtain public input on the myriad LPI issues concerning Fannie Mae and Freddie Mac. FHFA is understandably trying to minimize GSE and taxpayer costs, which we support.

LPI is a necessary tool in ensuring safe and sound consumer mortgage markets. Property insurance protects the interests of both the homeowner and the mortgage investor. Borrowers and investors benefit from LPI in the event of damage or loss of the property. This was evident in both Hurricanes Katrina and Sandy. Without this insurance, some borrowers would have lost their largest investment.

The Notice does not address all LPI issues, but is limited to two potential restrictions, concerning certain sales commissions and certain reinsurance activities. The Notice describes these as practices where there are concerns regarding conflicts between parties to insurance agreements. The Notice provides:

> "1. *Certain Sales Commissions.* The Enterprises shall prohibit sellers and servicers from receiving, directly or indirectly, remuneration associated with placing coverage with or maintaining placement with particular insurance providers.
> 2. *Certain Reinsurance Activities.* The Enterprises shall prohibit sellers and servicers from receiving, directly or indirectly, remuneration associated with an insurance provider ceding premiums to a reinsurer that is owned by, affiliated with or controlled by the sellers or servicer."

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FHFA describes these, not as a proposal, but as planned practice limitations. The Notice asks sweeping questions, including asking for input on enhancing the transparency and consumer and investor protections related to LPI, and whether there are data that would run contrary to the intended results.

The planned practice limitations are worded very broadly, undoubtedly because they are new and have not been fully considered and debated. It is difficult to produce meaningful input on the planned practice limitations because they are so general. Nevertheless, we offer the following comments.

Relevance of New CFPB Regulation

In analyzing the costs of LPI to the GSEs, we suspect that FHFA may be using an analysis that looks back in time, and that includes practices that no longer exist. Notably, in January 2014, a new Consumer Financial Protection Bureau ("CFPB") regulation will take effect. It governs LPI generally, and provides, in part:

> (1) *In general*. Except for charges subject to State regulation as the business of insurance and charges authorized by the Flood Disaster Protection Act of 1973, all charges related to force-placed insurance assessed to a borrower by or through the servicer must be bona fide and reasonable.
> (2) *Bona fide and reasonable charge*. A bona fide and reasonable charge is a charge for a service actually performed that bears a reasonable relationship to the servicer's cost of providing the service, and is not otherwise prohibited by applicable law.[1]

The CFPB's regulation requires LPI notices to borrowers, prohibits LPI charges unless there is a gap in required property insurance coverage, and requires LPI cancellation when the borrower obtains coverage, with reimbursement for LPI coverage that overlapped the borrower's policy.

We suggest that FHFA consider the extent to which this regulation and current practices address the FHFA's concerns. Specifically, if all LPI is in place only when needed as under the CFPB's regulation, and if all charges bear a reasonable relationship to the servicer's cost of providing the service, as also under the CFPB's regulation, how would the GSEs be inappropriately harmed? We encourage the FHFA to take into consideration the CFPB's servicing regulations so that a streamlined and coordinated set of regulations is advanced by the government.

Restrictions Should Be Tied to Actually Lowering the GSEs' costs

For the LPI issues covered in the Notice, FHFA seems to consider total LPI costs only, without tying the reasons for the costs to the practices the proposal would prohibit. There are several reasons for high LPI costs that exceed the scope of the Notice. For example, in the wake of the financial crisis, the average life of an LPI policy has lengthened, which has increased the total cost. Some states have exceedingly long foreclosure timelines,

[1] 12 C.F.R. § 1024.37(i), 78 Fed. Reg. 10696, 10882 (February 14, 2013).

and properties awaiting foreclosure have LPI in place for an extended period for this reason. Similarly, in disaster areas, properties may sit vacant for extended periods, again, with LPI in place. Looking at total LPI costs for the GSEs, or even for one of the GSEs, will mask the underlying reasons for the costs.

It is also unclear whether FHFA and the GSEs have researched the impact of catastrophic events on LPI rates. We are concerned that recent articles on loss ratios appear to look at losses that exclude major events, such as Hurricane Katrina, which are the most costly and drive up loss ratios.

We are also concerned that the planned practice limitations would ban certain transactions with affiliates broadly, without first establishing whether the fact of affiliation increases or decreases GSE costs.

The CFPB's regulation will not permit LPI costs above those that are reasonable, and that are for actual services performed. This regulation, however, does not directly address the level of deductibles. In light of the CFPB's regulation, we suggest that FHFA would make more progress by addressing deductibles.

As Drafted, Planned Practice Limitations Are Too Broad

The language in the planned practice limitations is very broad. The first limitation talks of placing or maintaining insurance, but does not mention who is doing the placing or maintaining. Both talk of insurance, without limitation to LPI. We would like to recommend that the language clarify where it applies.

Similarly, the language is not limited to insurance on real property. We acknowledge that FHFA stated in a footnote in the Notice that GSE actions only affect loans they purchase or guarantee, but that language would not be binding.

We suggest that the actual operative language make clear that the planned practice limitations apply only to lender-placed hazard insurance, and not flood insurance, on properties securing a loan backed by either Fannie Mae or Freddie Mac. Any practice limitations based on the Notice should be clear that they do not apply to voluntary insurance, insurance not required by a mortgage, or private mortgage insurance.

As drafted, the first planned practice limitation would prohibit direct or indirect:

> "remuneration associated with placing coverage with or maintaining placement with particular insurance providers."

Servicers are contractually obligated to place LPI coverage when a borrower does not obtain required coverage. Servicers incur costs in providing this service, and should be compensated for these costs. To the extent that the proposal would prohibit all compensation, direct or indirect, "associated" with placing coverage, or "associated" with maintaining placement when required, it is too broad. We do not believe this was FHFA's intent, but the language is so broad that we raise this concern.

Implementation Should Not Require a Breach of Contract or Noncompliance with the Law

The Notice solicits input regarding the time and difficulties associated with altering existing contracts. This is a significant question because existing contracts cannot necessarily be altered. For example, an LPI policy with a one-year term, and a one-year reinsurance contract, that is effective on June 1, 2013 will need to remain reinsured through June 1, 2014. The state that regulates the reinsurance program may not allow a mid-term cancellation of a reinsurance policy.

We recommend that any final practice limitations not require unwinding or altering existing contracts, and not require noncompliance with state law.

Conclusion

We support FHFA's careful consideration of the many complex LPI issues as it seeks to prevent unnecessary costs to the GSEs and taxpayers. We appreciate FHFA's continuing outreach for input on the effects of planned FHFA actions. We urge FHFA not to finalize its LPI restrictions without considering the extent to which the CFPB's LPI regulation would contribute to FHFA's goals. Finally, we request an opportunity to discuss these issues at the anticipated meeting FHFA plans with various stakeholders in June.

Sincerely,

Anne C. Canfield
Executive Director