Force-Placed Insurance

History of the Real Property Force-Placed Insurance Model Act-

During the Great Recession, the collapse of the housing market brought many unscrupulous corporate practices into the light. Force-placed insurance was one of them. Historically, the force-placed insurance industry was not well regulated and remains that way today. The National Association of Insurance Commissioners (NAIC) did develop a Creditor Placed Insurance Model Act in 1996, however, most states did not pass the 1996 Model Act. The 2008 Great Recession saw an influx of homeowners defaulting on their private insurance and ending up on lender-placed policies. The ensuing civil litigation exposed abusive corporate practices, including kickback schemes within the force-placed insurance industry. In 2012, the NAIC formed a force-placed working group and held its first public hearing. In 2015, the Federal Government Accountability Office produced a report highlighting the need for greater oversight and data collection on force-placed insurers. The NAIC's force-placed insurance working group model act was supposed to be completed in 2015. The development process was delayed by industry requests for 2 model acts, one for real property and the other for personal property. According to NAIC officials, they completed a data call in 2017 and used it to support a multi-state investigation and settlement with two force-placed insurers. NAIC officials initiated a broader data call effort that began in 2018. The NAIC force-placed insurance working group finally completed its Real Property Model Act in 2020.

What is Force-Placed Insurance?

A.k.a Lender-Placed Insurance or Collateral Protection Insurance

Mortgage loans include a requirement that the borrower maintains 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 the required evidence of insurance, the lender, through the loan servicer, may place insurance on the property serving as collateral for the loan and charge the borrower for this insurance.

Most mortgages are owned by either banking institutions or REITs (Real Estate Investment Trusts). To simplify things, we will refer to any entity that owns the lien as the "lender". All loans have a lender and a loan servicer. The lender may act as the loan servicer; these are referred to as private portfolio loans. REITs contract with companies that provide loan servicing. The loan servicing companies can also be lending institutions, for example, Wells Fargo, or they can be companies that do not offer any banking services and only act as loan servicers. More than 60% of mortgages in the United States are held in REITs. The REITs are bound by pooling and servicing agreements. A pooling and servicing agreement is a contract that is required when loans are pooled together and packaged into mortgage-backed securities.

When the lender hires a loan servicer, the loan servicing agreement, known as a pooling and servicing agreement, requires the loan servicer to maintain continuous insurance coverage on the properties serving as collateral for the loans. Force-Placed Insurance is an important tool for loan servicers to meet this requirement.

Force-placed insurance is a master insurance policy issued to the loan servicer as the policyholder and insured. A master policy means that the policy covers a group of properties and not just a single property like the homeowner's insurance policy purchased by a borrower. A master policy also means that the policy covers all properties serving as collateral for loans in a specified loan portfolio. If a property is not covered by a voluntary insurance policy purchased by the borrower, then the property becomes eligible for force-placed insurance coverage, and a certificate of coverage for the individual property is issued under the master policy.

The force-placed insurance 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". There are 3 primary reasons an force-placed insurance policy is enacted:

1) The borrower's homeowners insurance policy <u>is canceled</u> by the borrower
2) The borrower's homeowners insurance policy <u>is canceled</u> by the company
3) The borrower's homeowners insurance policy <u>lapses</u> because of non-payment of the premium.

To ensure that the property serving as collateral for its loans is always protected by insurance, the force-placed insurance 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. The force-placed insurance master policy covers all properties in the servicer's loan portfolio and provides coverage as needed.

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

The counterargument from consumer advocates is that the force-placed policies cost more because there are extra charges included in the pricing. The loan contract does not provide for the borrower to pay for kickbacks, insurance policy tracking fees, reinsurance premiums paid to lenders affiliates and subsidiaries, agent fees for nonexistent agent services, and premiums that are in fact penalties and are not related to the cost of insurance.

Most servicers **outsource all insurance tracking functions**, and other activities unrelated to force-placed insurance, to the companies providing the force-placed insurance coverage. This is part of the contract and the costs are passed on to any borrower who triggers an force-placed insurance policy.

For example, Assurant, through its business group called "Assurant Specialty Property", provides force-placed insurance, insurance tracking, and other "hazard outsourcing" or "insurance outsourcing" services, including:

- New Loan Boarding – entering data on new loans into the loan servicer's system of record.
- Loss Drafts – releasing payments from voluntary insurers to borrowers for claims under voluntary insurance policies.
- Escrow Administration – making payments from borrower's escrow accounts to voluntary insurers.

Who are the players?

The dominant players are SWBC, Balboa, Assurant, QBE Insurance Corporation, QBE Holdings, Inc., American Security Insurance Co. (ASIC), and American Bankers Insurance Co. of Florida. In 2015, ASIC and QBE were the two dominant companies that write force-placed policies, together they comprised at least 90% of the force-placed insurance market. Since 2015, the marketplace has expanded.

How large is the force-placed insurance issue?

The limited data that the Government Accountability Office was able to obtain indicates that force-placed insurance generally affects 1% - 2% of all mortgaged properties annually and has become less prevalent since the 2007-2009 financial crisis as foreclosures have declined. There are approximately 3.8 million mortgages in Florida, at the industry's self-reported statistics, 38,000 - 76,000 Floridians will deal with a force-placed insurance policy annually. Borrowers without escrow accounts are at greater risk (between 25 - 40% of borrowers). In the 2015 GAO report, force-placed insurance insurers said they must refund premiums if a borrower provides evidence of coverage, which occurs about 10% of the time.

In Florida, the property insurance marketplace is shrinking, with more than a dozen insurers leaving the state or becoming insolvent. CFPB regulations do not require servicers to maintain borrower-purchased coverage for mortgages with escrow accounts if they believe the property is vacant or that the borrower-purchased coverage was canceled or not renewed for reasons other than nonpayment. Regulatory and industry officials said that, as a result, force-placed insurance placement on escrowed mortgages primarily occurred when the previous insurer canceled or declined to renew coverage. The Florida marketplace failures will predictably raise the percentage of Florida homeowners impacted by force-placed policies.

https://www.gao.gov/assets/gao-15-631.pdf

How force-placed insurance policies became profitable-

In many instances, lenders turned force-placed insurance into a profit center by collecting commissions from insurers through lender-affiliated agents or brokers or by receiving below-cost or free services (such as tracking of loans) from insurers, and/or by directing the coverage to lender-affiliated captive reinsurers. This structure is called "reverse competition." Reverse competition is a market structure in which insurers compete for the lenders' business by providing things of value. These expenses are included in the premiums charged to borrowers, which significantly drives up the price. In other words, reverse competition is a market condition that drives up prices for the consumers, as opposed to normal competition, which drives down prices for consumers. Market forces do not discipline insurers to remove unreasonable expenses when reverse competition exists. An example of reverse competition is in Kunzelmann v. Wells Fargo Bank, where the force-placed insurance carrier paid the loan servicer subsidiary an 11% commission.

https://content.naic.org/sites/default/files/inline-files/committees_c_130613_birnbaum_fhfa_lpi_overview.pdf

State insurance regulators have primary responsibility for overseeing force-placed insurance insurers, but federal financial regulators generally oversee the servicers that purchase force-placed insurance coverage for their portfolios. However, a lack of comprehensive data at the state and national levels limits effective oversight of the force-placed insurance industry. For example, regulators lack reliable data that would allow them to evaluate the cost of force-placed insurance or the appropriateness of its use. The National Association of Insurance Commissioners (NAIC), which helps coordinate state insurance regulation, requires insurers to annually submit state-level force-placed insurance data, but the data were incomplete and unreliable. NAIC provides guidance for the reporting of these data and shares responsibility with state regulators for reviewing and analyzing the data, but neither has developed policies and procedures sufficient for ensuring their reliability. State and federal regulators have coordinated to collect more detailed national data to better understand the force-placed insurance industry, but insurers failed to provide them with all of the requested information, and whether and when they will is unknown. Without more comprehensive and reliable data, state and federal regulators lack an important tool to fully evaluate force-placed insurance premium rates and industry practices and ensure that consumers are adequately protected

Force-placed insurance rates are regulated by the state-

Force-placed insurance is subject to state insurance regulation, including rate and form reviews and approvals where applicable. The McCarran-Ferguson Act provides that state law governs the insurance business and is not superseded by federal law unless federal law specifically relates to the insurance business. State regulators license agents; review insurance products and premium rates, including force-placed insurance products and rates where applicable; and routinely examine insurers' financial solvency. State regulators also generally perform market examinations in response to specific consumer complaints or regulatory concerns and monitor the resolution of consumer complaints against insurers. NAIC is a voluntary association of the heads of insurance departments from the 50 states, the District of Columbia, and five U.S. territories. While NAIC does not regulate insurers, it provides services to make certain interactions between insurers and state regulators more efficient. These services include providing detailed insurance data to help regulators understand insurance sales and practices; maintaining a range of databases useful to regulators; and coordinating state regulatory efforts by providing guidance, model laws and regulations, and information sharing tools. In 1996, NAIC developed the force-placed insurance model legislation. In August 2021, the NAIC voted on and released new model legislation.

Force-placed insurance rates regulated by the federal government-

Although the business of insurance is regulated by the states, federal regulators generally have authority over regulated lenders' and their servicers' activities related to flood insurance, including flood force-placed insurance. The Board of Governors of the Federal Reserve System (Federal Reserve), Farm Credit Administration (FCA), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and National Credit Union Administration (NCUA) are the regulators responsible for overseeing the mandatory flood insurance purchase requirement for their institutions. Since the passage of the Flood Disaster Protection Act of 1973, flood insurance has been mandatory for certain properties in special flood hazard areas within communities participating in the National Flood Insurance Program (NFIP), and federal regulators have been responsible for enforcing compliance with this mandatory purchase requirement. In 1994, the enactment of the National Flood Insurance Reform Act required a regulated lending institution or a servicer acting on its behalf to notify borrowers of lapsed coverage, and if the borrower did not purchase coverage within 45 days of the notice, to purchase flood force-placed.16 The act clarified that servicers could charge the borrower for the cost of premiums and fees for flood force-placed insurance. It also required regulators to issue civil money penalties against regulated

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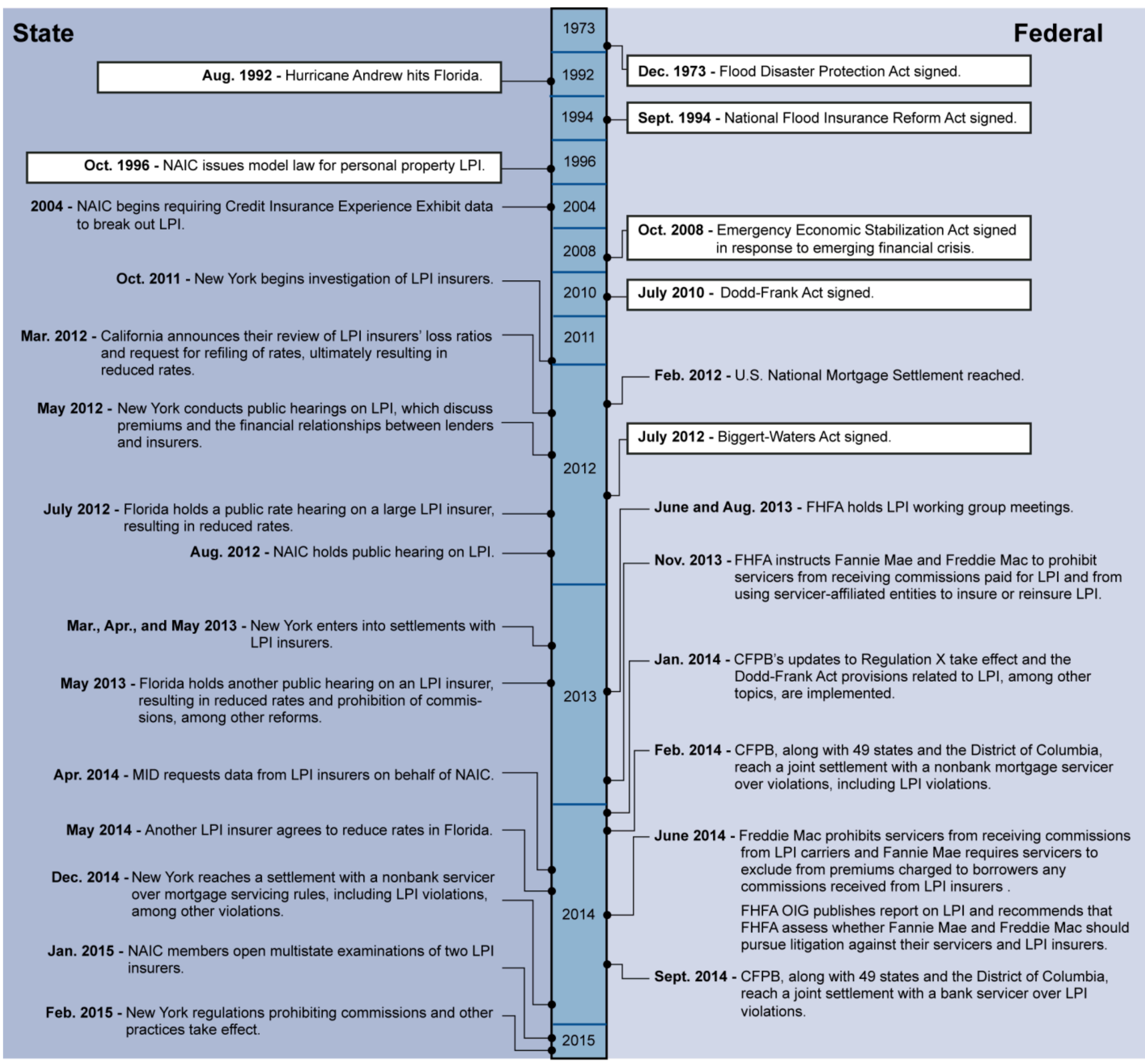
lending institutions for a pattern or practice of mandatory flood insurance purchase requirement violations, including force-placed insurance requirements. In 2012, the Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act) clarified that servicers could charge for flood force-placed insurance from the date of a coverage lapse or the beginning date of insufficient coverage and also required them to issue refunds to borrowers who provided proof of insurance for any period of duplicate coverage. Each of the federal regulators has issued regulations to implement flood force-placed insurance rules for their respective institutions.

Figure 3: Significant Events Related to LPI Oversight, 1973-2015



https://www.gao.gov/assets/gao-15-631.pdf

Insurance policy tracking-

Servicers generally contract with force-placed insurance providers to cover all the loans in their portfolios from the date any borrower-purchased coverage lapses, regardless of when the coverage lapse is discovered. According to industry officials, most servicers outsource tracking and notification services—that is, monitoring of the loans' insurance policies for possible lapses in coverage and communicating to borrowers that force-placed insurance will be placed unless the borrower provides proof of insurance—to force-placed insurance insurers or managing general agents. Because force-placed insurance insurers are responsible for losses that occur during coverage lapses, some of the larger insurers perform these services themselves.

Industry officials said that some smaller force-placed insurance insurers use a managing general agent to perform some or all of the tracking services, usually because setting up these services requires a large upfront investment, but generally continue to perform the notification services directly. Insurers typically factor the expenses associated with such activity into the force-placed insurance premium rates, which are based on the value of the underlying properties. When the servicer places an force-placed insurance policy, it pays the premium to the force-placed insurance insurer and reimburses itself with funds from the borrower's escrow account or by adding the premium amount to the loan's principal balance. In some cases, the insurer may pay a commission to the servicer or servicer's agent for the business and can also use a portion of its premium revenue to purchase reinsurance to hedge its risk of loss.

Keys:

- Per the pooling and servicing agreements, the servicer is responsible for insurance tracking – included in the loan servicing fee paid by mortgage owners (note holder)
- The tracking vendor's data system connects with the loan servicer's accounting system

- The tracking vendor maintains the insurance database and updates the servicer's system

Stage 1: Tracking vendors get the bulk of voluntary insurance information through the electronic data interchange (EDI) with voluntary insurers. The servicer's accounting system is updated to reflect evidence of the required insurance. Industry officials said that within about 2 weeks of a borrower-purchased policy's expected renewal date, the insurer generally receives renewal documentation on behalf of the servicer, and at this point, they have confirmed coverage for all but about **14% of loans**.

Stage 2: If the electronic data interchange (EDI) does not produce the required evidence, the vendor contacts the agent and/or insurer to confirm voluntary insurance. If outreach is successful, the servicer's accounting system is updated to reflect evidence of required insurance. This process typically reduces the number of loans whose coverage status is unknown to about **9% around the expiration date.**

Stage 3: If the electronic data interchange (EDI) or outreach to an agent or insurer does not produce the required evidence, a letter cycle to the borrower is initiated. Initiation of the notice letter cycle is automated. The insurer sends the first letter to the borrower asking for proof of coverage. If the borrower does not provide proof of coverage, the insurer must send a second letter at least 15 days before charging the borrower for force-placed insurance (and at least 30 days after sending the first notice). **This second letter is sent to about 3% of loans** whose coverage status has not yet been confirmed.

Stage 4: If evidence of insurance is not produced during the period of borrower warning letters and the servicer's accounting system does not show required insurance in place, there is an automated notification to the force-placed insurance insurer to issue coverage under the force-placed insurance policy. Servicers ultimately **place force-placed insurance coverage on 1 - 2% of borrowers** who do not respond to the notifications.

Stage 5: Servicer charges borrower for force-placed insurance – removes the amount of charge from the escrow if sufficient funds are available, servicer adds a charge to escrow if an escrow account exists, or creates an escrow account and adds charges to the new escrow. The industry reported they refund force-placed insurance premiums if the borrower provides evidence of coverage **about 10% of the time**. CFPB regulations require the insurer to cancel the force-placed insurance and refund all homeowners' force-placed insurance premiums and related fees for any overlapping coverage within 15 days of receiving proof of coverage.

CFPB regulations do not require servicers to maintain borrower-purchased coverage for loans with escrow accounts if they believe the property is vacant or that the borrower-purchased coverage was canceled or not renewed for reasons other than nonpayment. Regulatory and industry officials said that, as a result, force-placed insurance placement on escrowed loans primarily occurred when the previous insurer canceled or declined to renew coverage.

https://www.naic.org/documents/committees_c_130613_birnbaum_fhfa_lpi_overview.pdf

Retroactive Billing-

By the time the certificate of coverage is issued for new force-placed insurance coverage, at least 45 days have passed from the lapse of the voluntary policy, and a premium charge is billed retroactively from the period starting at the date of lapse for 1 full year of coverage.

Force-Placed Insurance Flood Insurance-

The mechanics of insurance tracking and placement of force-placed insurance are the same for force-placed flood insurance as for force-placed hazard insurance, but there are some additional issues with force-placed flood insurance.

Almost all voluntary flood insurance is provided by the National Flood Insurance Program (NFIP). There are caps on the amount of coverage provided under an NFIP policy. Even if a borrower has an NFIP flood policy, the coverage may not meet the lender's coverage amount requirements. Force-placed flood insurance is placed for the difference between the required amount of coverage and the amount of coverage provided by the NFIP policy. This is force-placed excess flood coverage.

Why are force-placed insurance rates and premium charges so much greater than homeowners insurance?

Industry arguments-

- Lack of individual underwriting and take-all-comers means force-placed insurance is much riskier than homeowners insurance for which the voluntary insurer can underwrite and reject individual properties.
- Force-placed insurance exposures are concentrated in cat-prone areas and, consequently, more susceptible to catastrophic losses.
- Force-placed insurance expenses are greater than expenses for homeowners insurance because of the special activities associated with administering an force-placed insurance policy.
- Force-placed insurance expenses are greater than expenses for homeowners because many or most force-placed insurance coverages are canceled before the full term of coverage.

Data doesn’t back up the industry arguments-

Based on the industry explanation for higher rates, we would expect higher force-placed insurance loss ratios than homeowners’ loss ratios. And we would also expect greater volatility in force-placed insurance loss ratios than homeowners loss ratios if force-placed insurance is more susceptible to catastrophic events. The loss ratio results from 2004 through 2012 show force-placed insurance loss ratios have been far less than homeowners’ loss ratios.

Homeowners and LPI Loss Ratios, Florida Only and All States Ex Florida, 2004-12

	FL HO	FL LPI	All State Ex FL HO	All States EX FL LPI
2004	303.0%	75.2%	52.2%	28.0%
2005	153.6%	102.5%	60.2%	47.9%
2006	32.6%	29.6%	58.7%	28.9%
2007	25.6%	11.4%	63.0%	22.2%
2008	33.9%	10.6%	86.6%	26.7%
2009	38.4%	11.7%	72.5%	24.7%
2010	38.1%	7.2%	72.5%	23.1%
2011	35.9%	9.9%	90.8%	32.6%
2012	31.6%	13.3%	72.2%	40.3%
2004-2012	61.4%	13.6%	70.9%	30.0%

Key takeaways-

- 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.
- The loss ratios for force-placed insurance seldom exceed 25%.
- Insurers and banks have built a network of relationships and financial arrangements that have driven premium rates to inappropriately high levels ultimately paid for by consumers and investors.

- Force-placed insurers have competed for business from banks and loan servicers through "reverse competition": i.e, rather than competing for business by offering lower prices, insurers have created incentives for banks and loan servicers to buy force-placed insurance with high premiums by enabling banks and loan services, through complex arrangements, to share in the profits associated with the higher prices.

NAIC Real Property Force-Placed Model Act-

Completed in December 2020, the Act regulates the following area:

- Calculation of Coverage and Payment of Premiums
- Prohibited Practices (reverse competition practices)
- Evidence of Coverage (provided to the homeowner)
- Filing Approval and Withdrawal of Forms (filing rules)
- Refund of Unearned Premiums
- Claims
- Rights and Obligations of the Parties
- Remittance of Premiums and Payment of Compensation
- Disclosures to the Debtor
- Enforcement
- Regulatory Authority
    - The commissioner may, after notice and hearing, promulgate reasonable regulations and orders to carry out and effectuate the provisions of this Act.
- Judicial Review
- Penalties
    - Payment of a monetary penalty of not more than $1,000 for each violation, but not to exceed an aggregate penalty of $100,000, unless the violation was committed flagrantly in a conscious disregard of this Act, in which case the penalty shall not be more than $25,000 for each violation not to exceed an aggregate penalty of $250,000; or
    - Suspension or revocation of the insurer's license.

https://us.eversheds-sutherland.com/portalresource/committee-index-real-property-lender-placed.pdf

Industry versus consumer talking points-

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Industry	Consumer
Force-placed insurance differs from other lines of business. Loan servicers are required by contract to provide coverage on properties where no other coverage is in place.	Force-placed insurance exhibits characteristics of "reverse competition," where the entity selecting the insurer is not the entity paying for the product.
Insurers provide coverage for all exposed properties in the servicer's portfolio without inspection or underwriting of the risk. This is a broad range of risks, including homes that are vacant, unoccupied, or in catastrophe-prone areas.	The existence of reverse competition does not drive down prices as normal competition would. Instead, insurers compete for lenders' business by providing financial considerations to the lender. These expenses are included in the premiums charged to borrowers, thus driving up the cost.
The product includes automatic, continuous and retroactive coverage provisions.	Force-placed insurance is a limited coverage compared to homeowners insurance because it includes no personal property, no additional living expenses, and no liability coverage.
Force-placed insurance premiums grew due to the mortgage crisis as more homeowners stopped making mortgage payments.	Force-placed insurance premiums quadrupled from 2004 to 2011. Leading Florida to file several Consent Orders
Industry advocates dispute the notion that lender-placed insurance operates in a market characterized by "reverse competition."	Despite the limited coverage, force-placed insurance loss ratios tend to be in the 15-24% range compared with 60-75% for homeowners insurance.
Insurers have chosen to exit the market rather than enter, despite claims of excess profits.	Compensation is given to loan servicers in the form of commissions, cash payments for marketing, or free/subsidized services for loan servicers.

Force-placed insurance is an important risk-management tool for lenders that provides value to homeowners.	There are unnecessary placements and inadequate disclosure to consumers regarding such transactions.
Force-placed insurance helps lenders satisfy regulatory requirements promulgated by federal regulatory agencies and facilitates the secondary market for mortgage-backed securities.	Commissions are far in excess of work/ service that is provided or necessary. Rates and charges are based on unreasonable expenses and unreasonable actuarial analysis and assumptions.
Force-placed insurance protects federal taxpayers and other policyholders and state taxpayers by keeping substantial numbers of policies out of residual market plans.	Sales through surplus lines insurers are not subject to state solvency and market regulatory standards.
Force-placed insurance is a safety net because homeowners have ample opportunity to avoid force-placed insurance and purchase other coverage.	The use of captive reinsurance is a tool to allow lenders or producers to garner additional profits at the expense of borrowers.
The importance of force-placed insurance has been growing, both as a result of increased demand for force-placed insurance in the wake of the nation’s housing crisis and also because of rising vulnerability of property to damage from increased catastrophe activity.	Reverse competition abuses are missed as they fall in between the cracks of insurance and banking regulation.

	Data demonstrates that the lack of underwriting only explains, at most, a small fraction of the higher force-placed insurance prices. Some borrowers do not have home insurance-and must be force placed-because they are higher risk and cannot get the coverage. However, most borrowers become force-placed because of non-payment of premiums, not higher insurance risk. The lack of underwriting should result in lower acquisition expenses for force-placed insurance writers.
	The force-placed insurance market is dominated by two insurers, whose agents are not "vetting and selecting" force-placed insurance insurers as they do for typical policies.
	Adopt a minimum loss ratio, allowing only reasonable expenses associated with the provision of force-placed insurance, and prohibiting expenses associated with servicing and profits that flow to lenders.

https://www.colodnyfass.com/blog/chaired-by-florida-office-of-insurance-regulation-deputy-commissioner-naic-working-group-to-review-creditor-placed-insurance-model-law-revisions-today/