



Report to the Ranking Member,  
Subcommittee on Financial Institutions  
and Consumer Protection, Committee  
on Banking, Housing, and Urban Affairs,  
U.S. Senate

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September 2015

# LENDER-PLACED INSURANCE

## More Robust Data Could Improve Oversight

Accessible Version

# GAO Highlights

Highlights of [GAO-15-631](#), a report to the Ranking Member, Subcommittee on Financial Institutions and Consumer Protection, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

## Why GAO Did This Study

Mortgage servicers use LPI to protect the collateral on mortgages when borrower-purchased homeowners or flood insurance coverage lapses. The 2007-2009 financial crisis resulted in an increased prevalence of LPI. Because LPI premiums are generally higher than those for borrower-purchased coverage, state insurance regulators and consumer groups have raised concerns about costs to consumers.

This report addresses (1) the extent to which LPI is used; (2) stakeholder views on the cost of LPI; and (3) state and federal oversight of LPI. GAO examined documentation, studies, and laws and regulations related to LPI, and interviewed stakeholders including state insurance and federal financial regulators, consumer advocates, insurers, servicers, and industry associations. GAO selected interviewees based on their involvement in the LPI market and other factors to obtain a diverse range of perspectives. GAO selected the seven state insurance regulators to interview based on a number of factors including LPI premium volume and involvement in the LPI market.

## What GAO Recommends

GAO recommends that NAIC work with state insurance regulators to collect sufficient, reliable data to oversee the LPI market. This includes working with state insurance regulators to develop and implement more robust policies and procedures for LPI data collected annually from insurers and to complete efforts to obtain more detailed national data from insurers. NAIC said it would consider the recommendations as part of its ongoing work in the area.

View [GAO-15-631](#). For more information, contact Alicia Puente Cackley at (202) 512-8678 or [cackleya@gao.gov](mailto:cackleya@gao.gov).

September 2015

## LENDER-PLACED INSURANCE

### More Robust Data Could Improve Oversight

## What GAO Found

Mortgage servicers purchase lender-placed insurance (LPI) for mortgages whose borrower-purchased insurance coverage lapses, most often because of nonpayment by the borrower or cancellation or nonrenewal by the original insurer. The limited information available indicates that LPI generally affects 1 percent to 2 percent of all mortgaged properties annually and has become less prevalent since the 2007-2009 financial crisis as foreclosures have declined. Although used more often when borrowers without escrow accounts (about 25 percent to 40 percent of borrowers) stop paying their insurance premiums, servicers also use LPI when an insurer declines to renew a policy. LPI insurers often provide services such as tracking properties to help servicers identify those without insurance and confirming coverage. LPI insurers said they must refund premiums if a borrower provides evidence of coverage, which occurs on about 10 percent of policies. The Federal Emergency Management Agency offers flood LPI, but industry officials said most servicers prefer private coverage because of more comprehensive coverage and lower rates, among other things.

LPI premium rates are higher than rates for borrower-purchased insurance, and stakeholders disagreed about whether the difference is justified. Insurers pointed out that they provide coverage for any property in a servicer's portfolio without a rigorous underwriting process, and the limited information requires higher rates. They added that LPI properties tended to have higher risk characteristics, such as higher-risk locations (along the coast) and higher vacancy rates because of foreclosures. But some consumer advocates and state regulators said that the factors that insurers cite for higher rates, as well as the insurers' limited loss histories, do not justify the magnitude of the premium differences. They also said borrowers have little influence over the price of LPI and that some insurers competed for the servicers' business by providing commissions to the servicer that passed the costs on to the borrower through higher premium rates. Insurers, however, said that LPI premium rates were filed with and approved by state regulators and that commissions were a standard industry practice, but their use had decreased.

State insurance regulators have primary responsibility for overseeing LPI insurers, but federal financial regulators generally oversee the servicers that purchase LPI coverage for their portfolios. However, a lack of comprehensive data at the state and national levels limits effective oversight of the LPI industry. For example, regulators lack reliable data that would allow them to evaluate the cost of LPI 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 LPI 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 LPI industry, but insurers failed to provide them 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 LPI premium rates and industry practices and ensure that consumers are adequately protected.

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## Abbreviations

|                    |   |
|--------------------|---|
| Biggert-Waters Act | Biggert-Waters Flood Insurance Reform Act                 |
| CFPB               | Consumer Financial Protection Bureau                      |
| CIEE               | Credit Insurance Experience Exhibit                       |
| Dodd-Frank Act     | Dodd-Frank Wall Street Reform and Consumer Protection Act |
| FCA                | Farm Credit Administration                                |
| FDIC               | Federal Deposit Insurance Corporation                     |
| Federal Reserve    | Board of Governors of the Federal Reserve System          |
| FEMA               | Federal Emergency Management Agency                       |
| FHFA               | Federal Housing Finance Agency                            |
| FIO                | Federal Insurance Office                                  |
| LPI                | lender-placed insurance                                   |
| MPPP               | Mortgage Portfolio Protection Program                     |
| NAIC               | National Association of Insurance Commissioners           |
| NCUA               | National Credit Union Administration                      |
| NFIP               | National Flood Insurance Program                          |
| NYDFS              | New York State Department of Financial Services           |
| OCC                | Office of the Comptroller of the Currency                 |
| OIG                | Office of Inspector General                               |
| RESPA              | Real Estate Settlement Procedures Act                     |

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September 8, 2015

The Honorable Jeff Merkley  
Ranking Member  
Subcommittee on Financial Institutions and Consumer Protection  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

Dear Senator Merkley:

Homeowners insurance and flood insurance help protect both borrowers and lenders from the financial losses that can arise when homes are damaged. If a borrower allows coverage to lapse or otherwise become inadequate or loses coverage and does not respond to the servicer's requests to provide proof of sufficient coverage, the mortgage loan documents allow the servicer to protect the mortgage holder's interest in the property by purchasing insurance to cover the collateral on the mortgage loan and charge the borrower for the premium.<sup>1</sup> Servicers' use of this type of insurance, known as lender-placed insurance (LPI), peaked during the 2007-2009 financial crisis as an increasing percentage of borrowers fell behind on their mortgage and insurance payments. According to officials from the National Association of Insurance Commissioners (NAIC), LPI accounted for about \$3 billion in premiums in 2014. Although this amount represents only about 0.1 percent of the overall U.S. insurance industry, LPI can have a significant impact on affected consumers because it is often more expensive than the borrower-purchased coverage it replaces.<sup>2</sup>

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<sup>1</sup>A mortgage servicer is a company that serves as an agent for the mortgage holder, and handles the management of the mortgage loan. Typically, a mortgage servicer processes loan payments and manages defaults, foreclosure proceedings, and notification of borrowers and investors.

<sup>2</sup>We use the term "borrower-purchased" to refer to the standard homeowners or flood insurance coverage that has lapsed or become insufficient and therefore triggered LPI placement. Others have used "voluntary insurance" to distinguish this coverage from LPI. In special flood hazard areas located in communities participating in the National Flood Insurance Program (NFIP), property owners who obtain mortgages from federally regulated lenders are required to purchase flood insurance.

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Questions have grown about LPI's financial effect on consumers during and since the 2007-2009 financial crisis. In particular, state insurance regulators and consumer groups have raised questions about the high cost of LPI, citing investigations and studies saying that the amount of claims that LPI insurers pay does not justify the premium rates.<sup>3</sup> These groups also expressed concerns that borrowers had little influence over the price of LPI because the lender selects the insurer. Further, they said that some insurers might compete for the servicers' business by providing commissions to the servicer and passing the costs on to the borrower through higher premium rates. Additionally, industry officials noted that LPI is more common for mortgages that are delinquent or in foreclosure. As a result, borrowers may pay higher premiums when they are already in financial distress. Insurers, however, have said that LPI policies have a number of risk characteristics that justify their higher premium rates and that they have rigorous processes to notify borrowers of the need to buy less expensive replacement coverage.

Because state law governs the business of insurance, state regulators have had the responsibility for overseeing homeowners LPI.<sup>4</sup> In recent years, three states have reviewed LPI premium rates and related activities and reached agreements with insurers on LPI practices aimed at ensuring premium rates are appropriate. Further, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), among other things, amended the Real Estate Settlement Procedures Act (RESPA) to establish requirements for mortgage servicers on borrower notification before charging for homeowners LPI, termination of homeowners LPI, and refunding premiums paid by the borrower for homeowners LPI while the borrower maintained borrower-purchased coverage, among other things.<sup>5</sup> In 2013, the Consumer Financial Protection Bureau (CFPB) amended Regulation X to implement RESPA's

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<sup>3</sup>Birny Birnbaum, *Overview of Lender-Placed Insurance Products, Markets, and Issues* (June 13, 2013), and J. Robert Hunter, testimony before the New York Department of Financial Services on Force-Placed Insurance, May 17, 2012.

<sup>4</sup>We use the term "homeowners LPI" to refer to the non-flood LPI that is subject to the Real Estate Settlement Procedures Act and the mortgage servicing rules enacted under it, known as Regulation X. Others have used "hazard" to distinguish non-flood LPI from flood LPI because homeowners insurance typically covers other risks such as theft and liability, but we chose "homeowners" to avoid implying that flooding is not a type of hazard.

<sup>5</sup>Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1463(a), 124 Stat. 1376, 2182 (2010) (codified at 12 U.S.C. § 2605(k)-(m)).

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LPI provisions added by the Dodd-Frank Act. CFPB's amendments to Regulation X became effective in 2014.<sup>6</sup>

You requested that we review the LPI industry and the role of federal and state regulators in monitoring LPI practices. This report (1) describes the extent to which LPI is used, (2) discusses stakeholder views on the cost of LPI, and (3) describes state and federal oversight of LPI. To address these objectives, we reviewed LPI laws and regulations, agency guidance, settlements involving LPI, hearings, and studies, as well as past GAO reports on homeowners, flood, and title insurance. We interviewed officials from 10 relevant federal agencies, including financial institution regulators, as well as a selection of state regulators, LPI insurers, bank and nonbank servicers, industry associations, and consumer advocates. We selected interviewees based on their involvement in the LPI market and other factors to obtain a diverse and wide range of perspectives. To understand states' oversight of LPI, we interviewed insurance regulators from California, Florida, Illinois, New Jersey, New York, Ohio, and Texas and reviewed their states' laws and regulations. We selected these states based on the volume of LPI premiums, rate filing processes, and LPI regulatory activity. This selection of states is not generalizable to all states. We also reviewed aggregated financial data that LPI insurers report annually to state regulators to compare premiums and claims data for LPI to that of borrower-purchased insurance, but we determined that the data were unreliable for our purposes. Finally, we obtained and reviewed policy- and servicer-level LPI data collected through an interagency data call to understand characteristics of the LPI market and assess LPI premium rates, but we limited our analysis to geographical data because the data were incomplete. We discuss data issues more fully later in this report.

We conducted this performance audit from March 2014 to September 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>6</sup>78 Fed. Reg. 10,696, 10,880 (Feb. 14, 2013) (codified at 12 C.F.R. § 1024.37).



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## Background

LPI, also known as “force-placed” or “creditor-placed” insurance, is an insurance policy purchased by a mortgage servicer on a home to ensure continuous coverage when the borrower’s homeowners or flood insurance lapses or otherwise becomes inadequate. Most investors, such as Fannie Mae and Freddie Mac, require continuous homeowners insurance coverage on properties that serve as collateral for loans, and mortgage contracts usually require that borrowers maintain continuous coverage to protect the investor’s financial interest in the property.<sup>7</sup> Regulated lending institutions are also required to ensure that borrowers obtain and maintain flood insurance for properties in special flood hazard areas.<sup>8</sup> If a borrower does not maintain continuous coverage as required by the mortgage contract, the servicer is required to purchase LPI and may charge the borrower for the associated premiums and costs.<sup>9</sup> As a result, LPI allows servicers to meet these requirements and protect the mortgage holder’s financial interest in the property. A distribution of LPI policies in 2013 can be seen in figure 1.

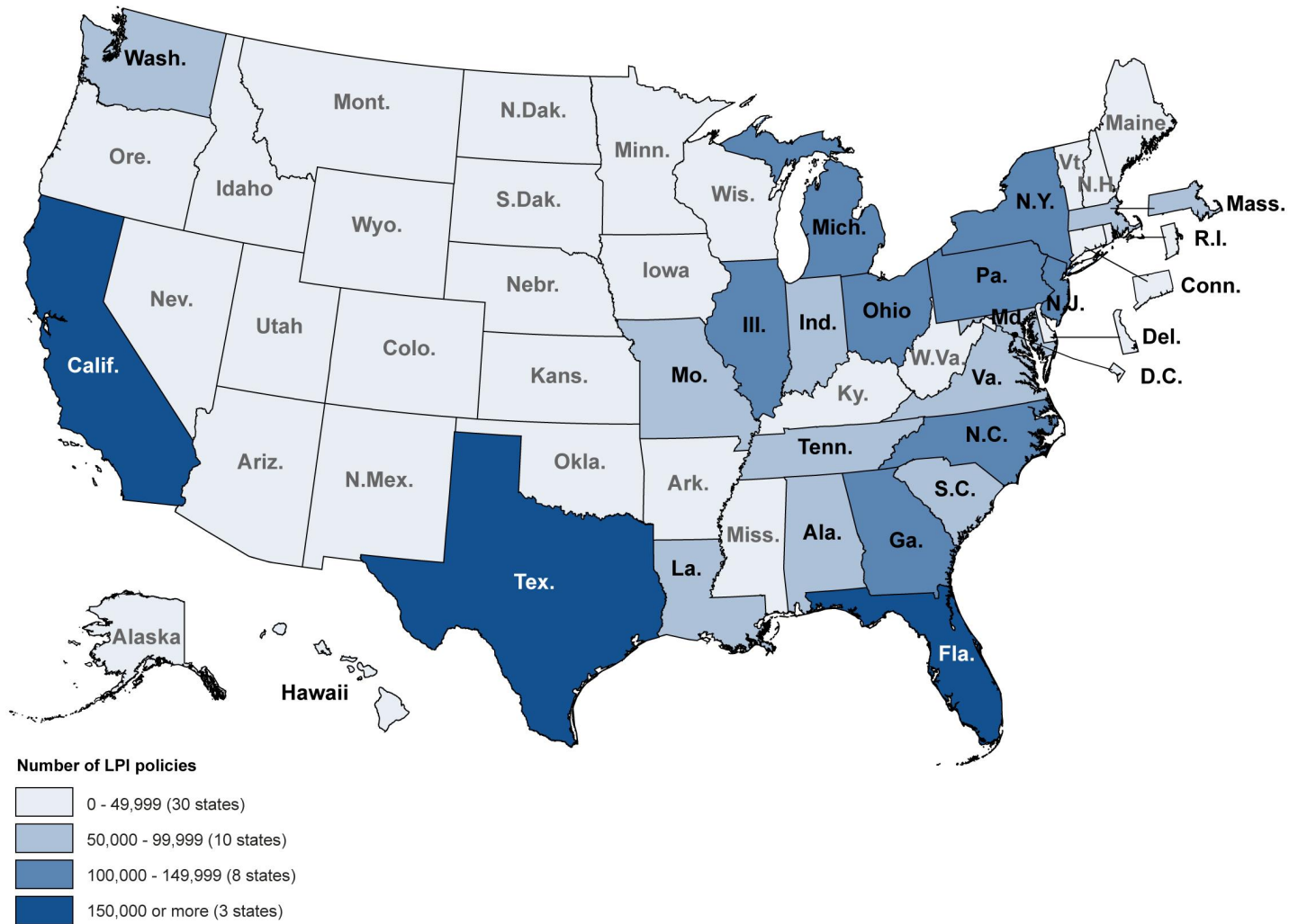
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<sup>7</sup>Fannie Mae and Freddie Mac are secondary market institutions that purchase conventional loans and issue securities backed by those loans. Both were established to provide liquidity, stability, and affordability in the secondary market for both single- and multifamily mortgages.

<sup>8</sup>Specifically, the mandatory purchase requirement for flood insurance applies to homeowners with mortgages held by federally regulated lenders on properties in participating communities identified by the Federal Emergency Management Agency (FEMA) to be in special flood hazard areas. 42 U.S.C. § 4012a. Special flood hazard areas are the land in the flood plain within a community subject to a 1 percent or greater chance of flooding in any given year according to flood maps developed by FEMA. 44 C.F.R. § 59.1.

<sup>9</sup>Under the Flood Disaster Protection Act, the servicer is required to purchase flood LPI in the event borrower-purchased coverage lapses or becomes inadequate after taking required steps such as providing notice to the borrower. See 42 U.S.C. § 4012a(e)(1)-(2).

**Figure 1: Numbers of LPI Policies Issued by State, 2013**



LPI – lender-placed insurance  
 Sources: GAO analysis of industry data and Map Resources (map). | GAO-15-631

## The LPI Process

Servicers generally contract with LPI providers to cover all the mortgages 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 mortgages’ insurance policies for possible lapses in coverage and communicating to borrowers that LPI will be placed unless the borrower provides proof of insurance—to LPI

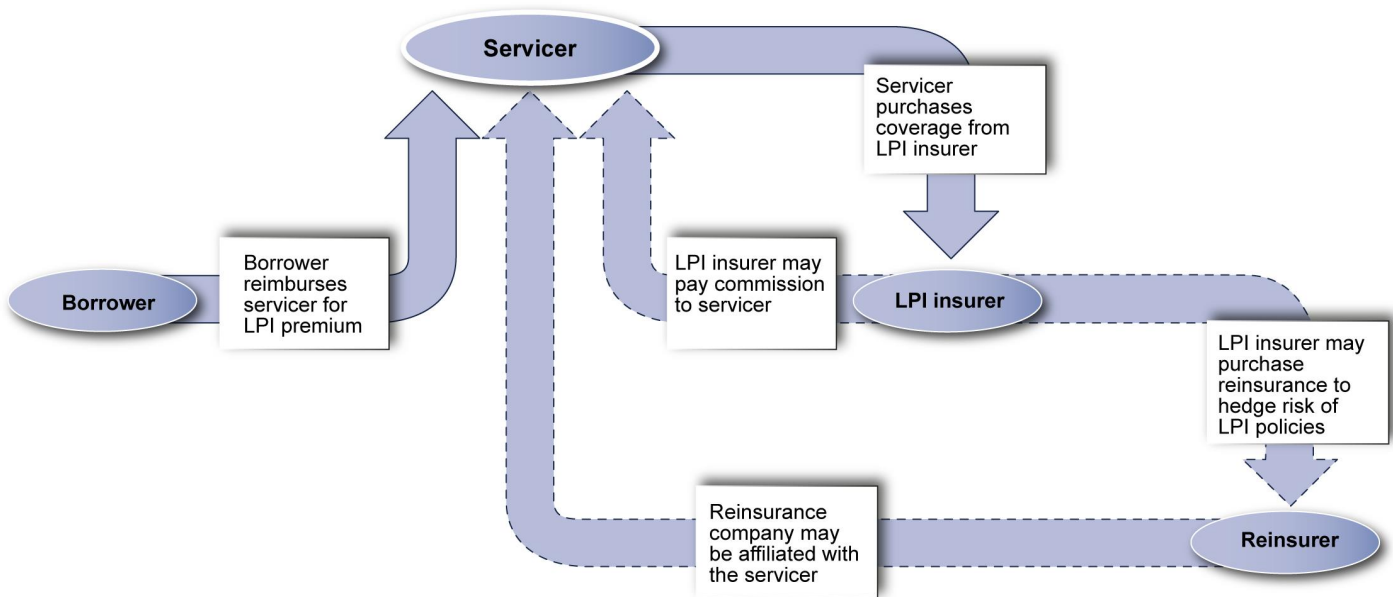
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insurers or managing general agents.<sup>10</sup> Because LPI insurers are responsible for losses that occur during coverage lapses, some of the larger insurers perform these services themselves. Industry officials said that some smaller LPI insurers 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 LPI premium rates, which are based on the value of the underlying properties. When the servicer places an LPI policy, it pays the premium to the LPI insurer and reimburses itself with funds from the borrower's escrow account or by adding the premium amount to the mortgage'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 (see fig. 2). Also in some cases, the company providing reinsurance to the LPI insurer could be affiliated with the servicer who placed the LPI policy.

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<sup>10</sup>We use industry officials to refer generally to officials from insurance industry associations, insurance companies, and bank and nonbank mortgage servicing companies with whom we spoke. A managing general agent is an insurance agent or broker that, unlike traditional agents or brokers, is vested with underwriting authority from an insurer.

**Figure 2: Potential Flow of Funds and Parties Involved in an LPI Transaction**



**Legend**

LPI – lender-placed insurance

Source: GAO analysis. | GAO-15-631

## Differences between LPI and Borrower-Purchased Insurance

LPI differs from borrower-purchased homeowners insurance in several ways. First, with borrower-purchased insurance, insurers evaluate the risks for individual properties and decide whether to cover a property and how much to charge. Because LPI covers all mortgages in a servicer’s portfolio, insurers do not underwrite properties individually. Instead, they provide coverage without assessing the condition of individual properties and provide coverage for a broader range of risks, including defaults and vacancies. Second, industry officials said that the servicer rather than the borrower is typically the named insured on the LPI policy, although in some cases, borrowers can be additional insureds who have the right to file a claim in the event of a loss, and their interest is included in any settlement. Third, servicers rather than insurers are responsible for determining the amount of coverage. Most servicers purchase the same amount of coverage that was available under the lapsed borrower-purchased policy. This amount approximates the replacement value of the home and protects the borrower’s financial interest and the servicer should the property be damaged. However, in some situations the servicer may not know the amount of coverage under the previous policy and may instead use the mortgage’s unpaid principal balance. Finally, LPI

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coverage may differ from the coverage provided by borrower-purchased insurance. Industry officials said that LPI policies typically insure the dwelling and other related structures on a property but often do not include the borrower's belongings or liability risks, as borrower-purchased policies do. However, one industry official said that LPI policies typically provide broader structural coverage, insure against vandalism, and continue coverage in the event of vacancy.

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## Role of State Insurance Regulators

Like borrower-purchased insurance, LPI 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 business of insurance and is not superseded by federal law unless a federal law specifically relates to the business of insurance.<sup>11</sup> State regulators license agents; review insurance products and premium rates, including LPI 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.<sup>12</sup>

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 regulation, and information-sharing tools. NAIC has coordinated state regulatory efforts on LPI by developing a model law for LPI and holding public hearings on LPI.<sup>13</sup> In

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<sup>11</sup>McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015).

<sup>12</sup>Market examinations are examinations of insurance companies to ensure that the companies doing business within their states comply with state laws and regulations with respect to rating, underwriting, and claim practices.

<sup>13</sup>NAIC was created, among other things, to coordinate regulation of multistate insurers and publishes model laws, regulations, and guidelines that state regulators can use as resources for developing their laws and regulations.

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1996, NAIC developed the Creditor-Placed Insurance Model Act, which serves as a guide for state legislation on LPI for personal property, such as automobiles.<sup>14</sup> Additionally, in August 2012, NAIC held a public hearing to discuss the use of LPI for mortgages and the effect of the practice on consumers.

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## Role of Federal Regulators

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 LPI. 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 (see table 1). 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.<sup>15</sup> 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 LPI.<sup>16</sup> The act clarified that servicers could charge the borrower for the cost of premiums and fees for flood LPI. It also required regulators to issue civil money penalties against regulated lending institutions for a pattern or practice of mandatory flood insurance purchase requirement violations, including LPI requirements. In 2012, the Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act) clarified

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<sup>14</sup>Generally, a model law or act is meant as a guide for subsequent legislation by states. State legislatures may adopt model laws in whole or in part, they may modify them to fit their needs, or they may opt not to adopt them.

<sup>15</sup>NFIP is administered by FEMA and is a part of the federal government's efforts to limit the damage and financial impact of floods. NFIP makes federally backed flood insurance available to property owners in participating communities. Flood Disaster Protection Act of 1973, Pub. L. No. 93-234, § 102, 87 Stat. 975, 978 (1973) (codified as amended at 42 U.S.C. § 4012a).

<sup>16</sup>National Flood Insurance Reform Act of 1994, Pub. L. No. 103-325, Tit. V, § 524, 108 Stat. 2255, 2259 (1994) (codified as amended at 42 U.S.C. § 4012a(e)).

that servicers could charge for flood LPI from the date of a coverage lapse or from 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.<sup>17</sup> Each of the federal regulators has issued regulations to implement flood LPI rules for their respective institutions.<sup>18</sup>

**Table 1: Federal Agencies and the Entities They Oversee for Flood and Homeowners Lender-Placed Insurance (LPI) Activities**

| Federal agency   | Regulated entities  |
|--|---|
| Board of Governors of the Federal Reserve System (Federal Reserve) | State-chartered banks that opt to be members of the Federal Reserve System, bank and thrift holding companies, the nondepository institution subsidiaries of those institutions, and nonbanks designated as systemically important by the Financial Stability Oversight Council |
| Consumer Financial Protection Bureau (CFPB)                        | Insured depository institutions and insured credit unions with more than \$10 billion in assets; certain nonbank entities including mortgage originators, brokers, and servicers; and larger participants of other markets for consumer financial products or services          |
| Farm Credit Administration (FCA)                                   | Farm credit system institutions   |
| Federal Deposit Insurance Corporation (FDIC)                       | State-chartered banks that are not members of the Federal Reserve System and federally insured state savings banks and thrifts  |
| Federal Housing Finance Agency                                     | Fannie Mae, Freddie Mac, and the 11 Federal Home Loan Banks   |
| National Credit Union Administration (NCUA)                        | Federally-chartered credit unions, and for certain requirements, federally insured state-chartered credit unions  |
| Office of the Comptroller of the Currency (OCC)                    | National banks, federal savings associations, and federal branches or agencies of foreign banks   |

Source: GAO. | GAO-15-631

Note: FDIC, Federal Reserve, OCC, and NCUA oversee compliance with the Real Estate Settlement Procedures Act (RESPA), including related to homeowners LPI, for banks and credit unions with less than \$10 billion in assets, and compliance with flood insurance requirements for regulated institutions of all sizes. FCA oversees compliance with RESPA, including LPI, and flood insurance activities of Farm Credit System Institutions. CFPB oversees compliance with RESPA in connection with the homeowners LPI and certain hazard insurance activities of banks or servicers with assets over \$10 billion. However, the CFPB's Regulation X specifically excludes certain hazard insurance, including that required by the Flood Disaster Protection Act of 1973, from its definition of "force-placed insurance." 12 C.F.R. § 1024.37(a)(2)(i).

<sup>17</sup>Biggert-Waters Flood Insurance Reform Act of 2012, Pub. L. No. 112-141, § 100244, 126 Stat. 916, 966 (2012) (codified at 42 U.S.C. § 4012a(e)).

<sup>18</sup>See 12 C.F.R. pts. 22, 172 (Office of the Comptroller of the Currency); 12 C.F.R. § 208.25 (Federal Reserve System); 12 C.F.R. pt. 339 (Federal Deposit Insurance Corporation); 12 C.F.R. pt. 614 (Farm Credit Administration); 12 C.F.R. pt. 760 (National Credit Union Administration).

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Federal regulators also have supervision and enforcement authority for their regulated entities' activities related to homeowners LPI. In 2010, the Dodd-Frank Act amended RESPA with specific provisions for homeowners LPI and granted CFPB rulemaking authority under RESPA. In 2013, CFPB adopted amendments to Regulation X to implement Dodd-Frank Act amendments to RESPA.<sup>19</sup> CFPB's amendments to Regulation X became effective in January 2014. The rules:

- prohibit servicers from charging borrowers for homeowners LPI unless they have a reasonable basis for believing that the borrower has not maintained homeowners insurance as required by the loan contract;
- require all charges to be bona fide and reasonable (does not cover charges subject to state regulation as the "business of insurance" and those authorized by the Flood Disaster Protection Act);
- require servicers to send two notices to borrowers before placing LPI;
- specify the content of the notices with model forms;
- generally prohibit servicers from obtaining homeowners LPI for borrowers with escrow accounts for the payment of hazard insurance whose mortgage payments are more than 30 days overdue unless the servicer is unable to disburse funds from the borrower's escrow account to ensure that the borrower's hazard insurance premiums are paid on time. The servicer is not considered unable to disburse funds because the borrower's escrow account contains insufficient funds or if the loan payment is overdue. A servicer is considered unable to disburse funds from a borrower's escrow account only if the servicer has a reasonable basis to believe either that the borrower's insurance has been canceled (or not renewed) for reasons other than nonpayment of premium charges or that the property is vacant. The

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<sup>19</sup>LPI rules in Regulation X do not apply to servicers' activities related to hazard insurance required by the Flood Disaster Protection Act or hazard insurance obtained by the borrower but renewed by the borrower's servicer under certain circumstances. 12 C.F.R. § 1024.37(a)(2). Additionally, Regulation X applies to servicers' mortgages that are federally related. Regulation X defines a federally related mortgage loan as any loan that, among other things, is secured by a first or subordinate lien on residential real property and is made by a federally regulated lender, creditor, or dealer; made or insured by an agency of the federal government; made in connection with a housing or urban development program administered by a federal agency; loans made and intending to be sold by the originating lender or creditor to Fannie Mae, Freddie Mac, or Ginnie Mae; is made by certain creditors that make or invest in residential real estate loans aggregating more than \$1 million per year; or is the subject of a home equity conversion mortgage or reverse mortgage issued by a lender or creditor subject to the regulation. 12 C.F.R. § 1024.2.



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servicer generally must advance funds through escrow to maintain the borrower's coverage; and

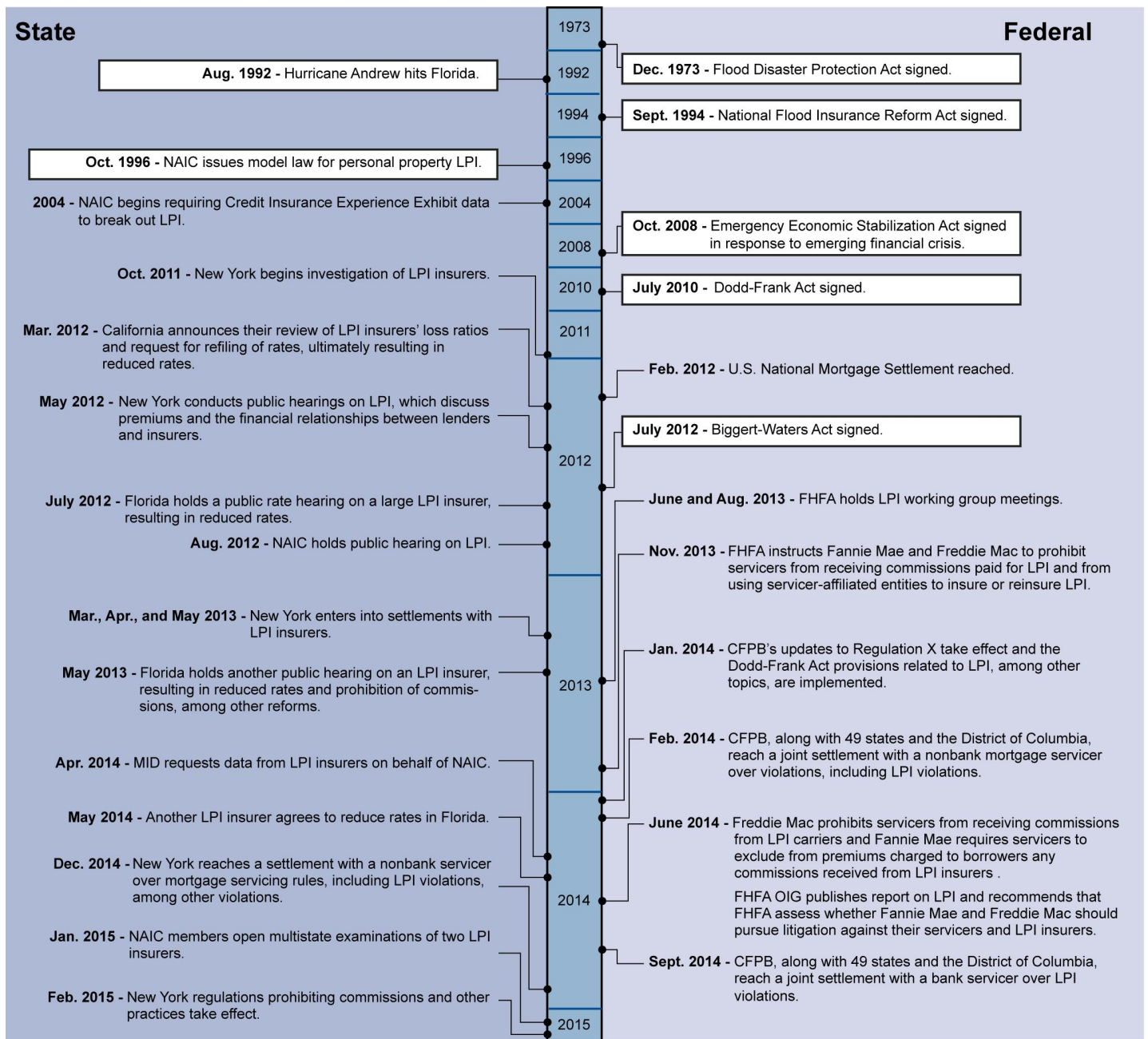
- specify procedures for terminating LPI and issuing refunds for duplicative premiums.

In addition to homeowners LPI provisions, amendments to Regulation X included new provisions related to escrow payments; error resolution and information requests; general servicing policies, procedures, and requirements; loss mitigation activities; and mortgage servicing transfers. Mortgage servicers that service loans for investors in mortgage-backed securities must also comply with LPI rules required by their investors, particularly from Fannie Mae and Freddie Mac. In November 2013, the Federal Housing Finance Agency (FHFA), which oversees these entities, directed Fannie Mae and Freddie Mac to issue guidance to their servicers on LPI. In December 2013, the entities issued corresponding guidance, prohibiting their servicers and affiliated entities from receiving commissions or similar incentive-based compensation from LPI insurers and servicers' affiliated companies from providing LPI insurance, including any reinsurance arrangements.<sup>20</sup> See figure 3 for a summary of these and other key events related to LPI oversight.

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<sup>20</sup>Specifically, Freddie Mac prohibits servicers from receiving commissions from LPI carriers, and Fannie Mae requires servicers to exclude from premiums charged to borrowers any commissions received from LPI carriers.

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



**Legend**

Biggert-Waters Act – Biggert-Waters Flood Insurance Reform Act  
 CFPB – Consumer Financial Protection Bureau  
 Dodd-Frank Act – Dodd-Frank Wall Street Reform and Consumer Protection Act

FHFA – Federal Housing Finance Agency  
 LPI – lender-placed insurance  
 MID – Mississippi Insurance Department

NAIC – National Association of Insurance Commissioners  
 OIG – Office of Inspector General

Source: GAO. | GAO-15-631

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## Few Mortgages Receive LPI, and Those That Do Usually Receive It Due to Premium Nonpayment by the Borrower or Coverage Cancellation by the Original Insurer

Mortgage servicers and LPI insurers use tracking and notification processes to determine when required coverage lapses and LPI is necessary. They ultimately place LPI on about 1 percent to 2 percent of mortgages in their portfolios, usually resulting from borrowers not paying their insurance premiums or the original insurers canceling or not renewing coverage. Servicers and insurers said that they use the tracking and notification systems to ensure that LPI placement is as accurate as possible, but that they must refund premiums when the borrower provides proof of coverage, which occurs on about 10 percent of policies. Finally, the Federal Emergency Management Agency (FEMA) offers flood LPI through its Mortgage Portfolio Protection Program (MPPP), but servicers generally said that they prefer private flood LPI coverage for a number of reasons, including more comprehensive coverage and lower premium rates.

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## Tracking and Notification Processes Identify a Small Percentage of Mortgages Requiring LPI

Mortgage servicers place LPI on a small percentage of mortgages when required coverage lapses, usually as a result of nonpayment by the borrower or cancellation or nonrenewal by the insurer. According to industry officials, mortgage servicers ultimately place homeowners LPI coverage on 1 percent to 2 percent of the mortgages in their portfolio.<sup>21</sup> They said that placement rates were often under 2 percent prior to the 2007-2009 financial crisis but peaked at about 3 percent at the height of the crisis due to increased delinquencies.<sup>22</sup> Industry officials said that placement rates increased as borrowers stopped paying their homeowners or flood insurance premiums along with their mortgage payments. One consumer advocate said that LPI placement rates were much higher for subprime lenders and may have peaked at 15 percent to 20 percent for some of them. Industry officials also said that placement rates were much higher for mortgages that were delinquent or in foreclosure. For example, one official said that its company's placement rate was 0.6 percent for current loans, compared with 17 percent for noncurrent loans. Industry officials said that even as the housing market has improved, properties can remain in foreclosure for an extended

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<sup>21</sup>In general, this section on placement, tracking, and notification focuses on homeowners LPI and the corresponding CFPB regulations, rather than flood LPI.

<sup>22</sup>This number reflects the overall placement rate and is higher than the initial placement rate mentioned later because it includes LPI policies that have been renewed.

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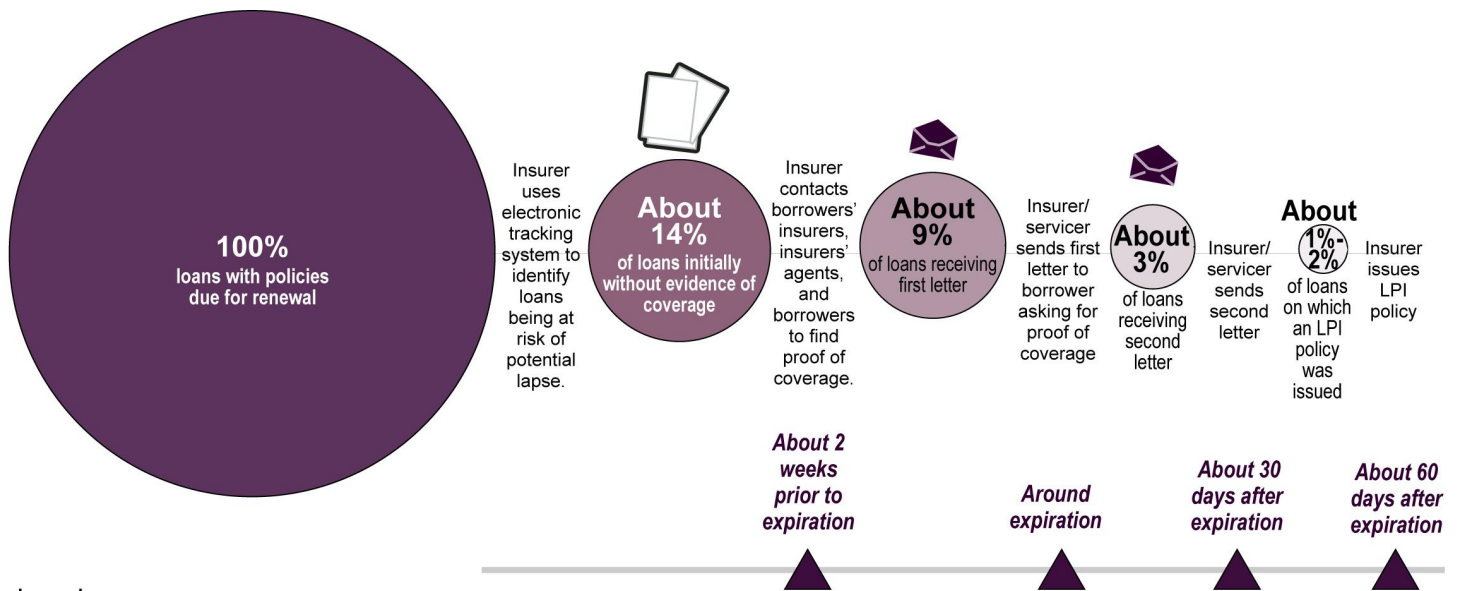
period of time in some states, keeping the placement rate above its pre-crisis level. However, they said that they expected the rate to continue to decline as older foreclosures were resolved.

As discussed earlier, some LPI insurers perform tracking and notification services for servicers both to manage their exposure and to meet the needs of servicers. As part of the tracking process, the insurer (or insurer's agent) monitors mortgages on behalf of the servicer for possible lapses in borrower-purchased coverage—for example, when coverage has been canceled or is about to expire. One industry official said that this process involves obtaining and reviewing millions of insurance documents each year, many of which are in hard copy and not in a standardized format, and updating the servicers' records accordingly. 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 percent of mortgages (see fig. 4). If the insurer does not receive this documentation, it contacts borrowers' insurers, their agents, and the borrowers themselves for proof of coverage. This process typically reduces the number of mortgages whose coverage status is unknown to about 9 percent around the expiration date. If renewal documentation does not arrive and the renewal date passes, the insurer sends a first letter to the borrower asking for proof of coverage.<sup>23</sup> 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 LPI (and at least 30 days after sending the first notice), this time with the cost or a reasonable estimate of the LPI policy's premium. This second letter is sent to about 3 percent of loans whose coverage status has not yet been confirmed. Industry officials said that insurers had such notification procedures in place prior to the CFPB regulations, but noted that the regulations had helped standardize and clarify the notification letters.

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<sup>23</sup>12 C.F.R. § 1024.37(c)(1)(i). CFPB regulations require servicers to wait at least 45 days after sending this letter before charging the borrower for LPI coverage.

**Figure 4: LPI Insurer Tracking and Notification Process**



**Legend**

LPI – lender-placed insurance

Source: GAO analysis of information provided by insurers. | GAO-15-631

By the end of this process, the insurer is generally able to confirm borrower-purchased coverage for most of the mortgages in a servicer's portfolio, but servicers ultimately place new coverage on the approximately 1 percent to 2 percent of borrowers who do not respond to the notifications.<sup>24</sup> Industry officials said that because CFPB regulations require servicers to complete the 45-day notification process before charging for LPI coverage, most LPI policies are not issued until at least 60 days after the borrower's insurance lapses. However, they said that most LPI policies are retroactive to the date of the insurance lapse. Industry officials said that LPI policies had a 1-year term but that most were canceled before the policy expired because borrowers eventually obtained the required borrower-purchased coverage to replace the LPI policy.

<sup>24</sup>This number reflects the initial placement rate and is lower than the overall placement rate mentioned earlier, which includes LPI policies that have been renewed.

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## LPI Is Most Often Placed on Non-Escrowed Mortgages When Borrowers Stop Paying Required Homeowners Insurance Premiums

According to industry officials and consumer advocates with whom we spoke, most LPI policies are placed on mortgages without escrow accounts when borrowers stop paying premiums on their required homeowners insurance policies. Industry officials said that mortgages with escrow accounts require LPI less often, because Regulation X requires mortgage servicers to use escrow funds to maintain borrower-purchased coverage—even when the escrow funds are insufficient.<sup>25</sup> Industry officials noted that these regulations had had little effect on the LPI industry because servicers already maintained coverage for escrowed borrowers, including when escrow funds were insufficient. Additionally, industry officials with whom we spoke also estimated that 60 percent to 75 percent of U.S. mortgages had escrow accounts. Industry officials said that mortgages without escrow accounts are more likely to require LPI because servicers do not have escrow accounts to draw on to continue paying borrower-purchased insurance premiums.

However, 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.<sup>26</sup> Regulatory and industry officials said that, as a result, LPI placement on escrowed mortgages primarily occurred when the previous insurer canceled or declined to renew coverage. Regulatory and industry officials said that cancellation or nonrenewal happens for a number of reasons, most commonly because of a change in occupancy status, especially vacancy, often in connection with a foreclosure. They also cited other reasons, including a history of large losses on the property, a change in the condition or risk of the property, the borrower's failure to maintain or repair the property, a misrepresentation of the property's characteristics on the insurance application or other violations of the insurance contract, or a desire by the insurer to limit their concentration of risk in a particular high-risk geographic area. Even state residual insurance programs, which are designed to be insurers of last resort, may refuse to insure some high-risk properties, particularly those that are vacant. In addition, industry officials said that high risks in some areas could make borrower-purchased coverage difficult to obtain—for example, parts of the Gulf Coast and especially Florida—and result in placement of LPI. Industry

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<sup>25</sup> See 12 C.F.R. § 1024.17(k)(5).

<sup>26</sup> See 12 C.F.R. § 1024.17(k)(5).

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officials said that a much less frequent cause of LPI placement was administrative errors that occurred, for instance, when a mortgage was transferred to a new servicer and the insurer was not notified. Industry officials said these errors were rare, but they did not provide more specific data.

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### Insurers Said They Refund Premiums on about 10 Percent of Policies

LPI insurers with whom we spoke said that they used the tracking and notification process to ensure that flood and homeowners LPI placement was as accurate as possible. However, industry officials and a consumer advocate said that insurers generally determined that placement was unnecessary for about 10 percent of the LPI policies they issued. Industry officials said that this unnecessary placement usually occurs because the borrower does not provide proof of coverage until after the LPI policy is placed, despite multiple requests from the servicer. CFPB regulations require the insurer to cancel the LPI and refund all homeowners LPI premiums and related fees for any overlapping coverage within 15 days of receiving proof of coverage.<sup>27</sup>

Industry officials told us that insurers had no incentive to place LPI unnecessarily, because doing so generated administrative expenses without a corresponding receipt of premium. For example, insurers incur expenses for corresponding with borrowers through calls and letters, issuing the policy, processing the cancellation, and issuing the premium refund. In addition to avoiding unnecessary expenses, industry officials said that insurers also want to avoid exposing their clients (the servicers) to borrower dissatisfaction and complaints. However, consumer advocates have cited unnecessary placements as an issue that needs to be addressed. While borrowers eventually receive a full refund of any unnecessary premiums, they may also be inconvenienced by having to initially pay the premium and go through the process of getting the policy canceled. One consumer advocate also cited concerns about unnecessary placement of flood LPI, particularly that borrowers incurred costs, such as hiring surveyors, to refute the servicer's determination that flood insurance was necessary.

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<sup>27</sup>12 C.F.R. § 1024.37(g).

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## FEMA Offers Flood LPI, but Servicers Prefer Private Coverage

LPI is also used when mandatory flood insurance policies lapse. The Flood Disaster Protection Act of 1973 requires flood insurance for properties in special flood hazard areas located in communities participating in NFIP that secure mortgages from federally regulated lenders.<sup>28</sup> FEMA offers flood LPI coverage through MPPP, but most servicers obtain coverage through private insurers. FEMA officials said that as of March 2015, MPPP had about 800 policies, a small number compared with the approximately 5.2 million policies in its National Flood Insurance Program, the primary provider of borrower-purchased flood coverage. Industry officials told us that MPPP was mostly used by smaller servicers that did not have access to LPI insurers that offer flood LPI.

Industry officials cited a number of reasons that servicers preferred to do business with private flood LPI insurers rather than FEMA's MPPP. First, industry officials said that private insurers would provide coverage from the date of lapse. Industry officials said that MPPP policies, in contrast, do not allow for automatic coverage upon lapse of borrowers' policies, resulting in the possibility of short periods with no coverage in place, while investors require the servicer to ensure continuous coverage. Second, industry officials said that private flood LPI rates are lower than MPPP rates, although they are still higher than rates for borrower-purchased flood insurance. For example, some told us that MPPP policies were about 4 times more expensive than private LPI flood policies, making MPPP a less attractive option. Further, some industry officials said that using MPPP for flood LPI would require servicers to have two insurers, one for homeowners LPI and one for flood, but that most servicers preferred to have the same insurer for both lines.

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<sup>28</sup>Flood Disaster Protection Act of 1973, Pub. L. No. 93-234, § 102, 87 Stat. 975, 978 (1973) (codified as amended at 42 U.S.C. § 4012a).



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## Stakeholders' Views on LPI Rates and Practices Were Mixed

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### Industry Officials Provided a Number of Reasons for LPI's Higher Premium Rates

According to one actuary who works with LPI, premium rates are determined by looking at expected losses (both catastrophic and noncatastrophic), expected other expenses, and target profit commensurate with the exposure and risk. Several industry officials said that some of the ways that LPI insurance differs from typical homeowners insurance can make LPI rates higher than borrower-purchased insurance. These differences include the following:

- **Covering all properties regardless of associated risk:** LPI insurers do not underwrite individual properties, but instead agree to cover all properties in a servicer's mortgage portfolio and cannot reject coverage for high-risk borrowers. Insurers told us previously that to manage risk, they need the ability to accept and reject applicants as necessary.<sup>29</sup> Some industry officials told us that because of the lack of information on the risks associated with the covered properties, insurers set LPI premium rates higher than rates for fully underwritten borrower-purchased insurance.
- **Higher geographical concentrations of high-risk properties:** Some industry officials told us that the inability to reject coverage for high-risk borrowers resulted in LPI insurance portfolios having large concentrations of high-risk properties—including in coastal states prone to catastrophic damage—that did not generally exist in borrower-purchased insurance portfolios. For example, one LPI insurer said that approximately 70 percent of its premiums in 2014 were in what it considered to be hurricane-exposed states.<sup>30</sup>
- **Higher concentrations of delinquent mortgages:** Several industry officials said that LPI policies were more likely than borrower-

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<sup>29</sup>GAO, *Flood Insurance: Strategies for Increasing Private Sector Involvement*, [GAO-14-127](#) (Washington, D.C.: Jan. 22, 2014).

<sup>30</sup>The insurer said it considered the following states and territories to be hurricane exposed: Alabama, Connecticut, Delaware, Florida, Georgia, Hawaii, Louisiana, Maryland, Massachusetts, Mississippi, New Jersey, New York, North Carolina, Puerto Rico, Rhode Island, South Carolina, Texas, the U.S. Virgin Islands, and Virginia.

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purchased insurance policies to cover mortgages that were in delinquency and foreclosure. According to one insurer, 30 percent to 35 percent of its LPI policies as of March 2015 were on mortgages that had been delinquent for at least 90 days.<sup>31</sup> Several industry officials said that properties in foreclosure are often vacant and inadequately maintained, increasing the risk and therefore the potential cost to the insurer.

- **Additional administrative costs:** Several industry officials also told us that LPI policies carried additional administrative costs. These costs can include tracking mortgages, obtaining reinsurance, and notifying homeowners of potential lapses. According to one LPI insurer, these efforts require significant and ongoing investments in technology that help effectively manage risk exposure and lower unnecessary placements. Further, several insurers said they also incur costs for communicating with borrowers during the notification process and when LPI is placed unnecessarily.

Several industry officials also pointed out that investors and servicers bore at least some of the cost of LPI, especially on delinquent mortgages. One LPI insurer said that based on its own calculations, 35 percent of LPI premiums were paid by someone other than the borrower, usually the investor, and that this percentage had decreased in recent years.<sup>32</sup> According to industry officials, when borrowers do not recover from delinquencies, investors—which could include Fannie Mae and Freddie Mac—typically reimburse servicers for the cost of LPI premiums once the foreclosure process is complete, which in some cases can take years.

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## Stakeholders' Views Differed on the Appropriateness of LPI Premium Rates

According to several consumer advocates and state regulators, some LPI premiums were higher than they should be. NAIC's general principles for determining premium rates state that they should not be inadequate, excessive, or unfairly discriminatory. Some of the advocates and regulators cited low loss ratios—claims and adjustment expenses as a percentage of premiums—as evidence that the policies were priced too highly. For example, one study by a consumer advocate examined loss

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<sup>31</sup>According to the Mortgage Banker's Survey, the 90-day delinquency rate on all single-family residential mortgages was 2.25 percent in 2014.

<sup>32</sup>According to the LPI insurer, this percentage had decreased from about 50 percent during the mortgage crisis.

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ratios from 2004 through 2012 and found that the average LPI loss ratio was 25.3 percent, compared with 63 percent for borrower-purchased insurance.<sup>33</sup> Further, it found that the LPI loss ratio was lower than the borrower-purchased loss ratio in each of the 9 years in that time period.

Industry officials responded to these assertions by noting that LPI claims were highly volatile and needed to be examined over much longer loss histories. They said that insurers set rates prospectively using models to estimate the full range of expected losses before they occurred and that these rates were reviewed by most state regulators as part of the rate filing process.<sup>34</sup> They added that a loss ratio analysis, instead, is a retrospective process because it examines rates after the losses have occurred and is only one of many factors that state regulators consider when conducting an actuarial review of the filed rates.

Some insurers also said that the potential for catastrophic losses in some years requires rates that may exceed losses in other years. For example, some LPI insurers have said that LPI may have lower losses in many years but significantly higher losses in catastrophic years, offsetting the profits from lower loss years. However, California and New York required insurers in their states to resubmit rate filings with lower rates because, based on their review of some insurers' loss histories in recent years, they did not see the pattern of profits from lower loss years offsetting significantly higher losses in catastrophic years.

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<sup>33</sup>Birny Birnbaum, *Overview of Lender-Placed Insurance Products, Markets, and Issues*, Lender-Placed Insurance Regulatory Working Group Outreach Session (June 13, 2013).

<sup>34</sup>Specifically, one actuary stated that a calculation of actuarially sound rates involves the following formula: (1) expected noncatastrophe loss per policy in prospective rate period, (2) expected catastrophe loss per policy in prospective rate period, (3) expected loss adjustment expense in prospective rate period, (4) expected expense during prospective rate period, and (5) target profit and contingencies commensurate with exposure and risk.

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## Some Consumer Advocates and State Regulators Said Several Factors Resulted in Higher Rates and Other Practices That Harmed Consumers, but Industry Officials Disagreed

Consumer advocates said that the primary cause of higher LPI rates was reverse competition—a market structure that drives up prices for consumers because insurers compete for mortgage servicers’ business rather than consumers’ business—by providing financial incentives to the servicer. They said that borrowers had little or no influence over the price of the insurance because the servicer was responsible for selecting it and that the costs of the financial considerations were passed on to the borrower. They also said that some insurers have paid commissions to servicers or servicers’ agents and that the servicers and agents did little work to justify them. They said that these commissions contribute to higher premium rates. One industry official, however, said that commissions were a standard industry practice and that their costs were within reasonable ranges. After reviewing proposals from Fannie Mae and Freddie Mac on reducing expenditures related to LPI, FHFA in November 2013 instructed the enterprises—i.e., Fannie Mae and Freddie Mac—to prohibit servicers from receiving commissions paid for LPI. FHFA, as well as an insurer and a servicer with whom we spoke, told us that the use of commissions had decreased since then.

Some state regulators noted that some insurers provided tracking and other services for free or below cost, benefitting the servicer, but included the costs of such services in what they charge consumers. One regulator and a consumer advocate said that some LPI insurers have purchased reinsurance at inflated prices from reinsurers owned by the lender. They said this overpayment to the reinsurer affiliated with the servicer could be a benefit to the servicer for purchasing LPI coverage from the insurer. One insurer and an industry official with whom we spoke commented that the use of affiliated reinsurers had decreased in recent years, with the industry official adding that this was at least in part due to the enterprises’ guidance, which also prohibited their servicers from entering into reinsurance arrangements with LPI providers.

Some consumer advocates also said that the concentrated LPI market further contributed to high premiums. Two insurers account for most of the LPI market, with estimates of their market share ranging from 70 percent to 90 percent. Industry officials said that the two largest insurers had extensive systems to track large servicers’ mortgage portfolios, and one consumer advocate said that the expense of setting up such systems could be a barrier to entry for smaller insurers that must often outsource tracking services to independent agents. Some industry officials said that recent state and federal actions—for example, state actions establishing minimum loss ratio requirements—could have the unintended consequence of forcing smaller insurers out of the market because of

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increased compliance costs. This limited competition, they said, could contribute to higher premium rates. One insurer said that there were at least 10 major LPI insurers in the United States in 1992. The insurer said that since then, catastrophic losses—notably Hurricane Andrew in 1992—and other related factors have resulted in the majority of them choosing to exit the market. The insurer told us that most insurance companies were not willing to assume the level of risk involved in LPI.

Finally, consumer advocates and some state regulators said that LPI had other negative effects on consumers in addition to the financial hardship of higher premiums. For example, they said LPI offers more limited coverage than borrower-purchased insurance. In particular, the policies purchased by the servicer for the borrower to protect the mortgage holder do not cover contents (personal property), liability, or additional living expenses. The servicer, not the borrower, is typically the primary insured party on an LPI policy and therefore determines the amount of coverage. Some state regulators said that as a result, the servicer may, in some cases, select coverage for the mortgage's unpaid principal balance, which would not cover the property's replacement cost. Some industry officials, however, said that servicers prefer to use the coverage amount the borrower had in place for the lapsed policy when it is known.

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## Some State and Federal Regulators Have Taken Actions Related to LPI, but Incomplete Data Limit Oversight

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### State Oversight of LPI Varies

Oversight of homeowners LPI varied across selected states in terms of requirements, reviews of LPI practices, and the rate filing process. NAIC does not have a model law or guidelines to address LPI for real

property.<sup>35</sup> We found variations in the regulatory treatment of LPI among the seven states we reviewed. For example, of the states we reviewed, only New York had adopted regulatory requirements applicable to LPI insurer practices.<sup>36</sup> New York's LPI regulations applicable to insurers include requirements for insurers and affiliates to notify the borrower before issuing LPI and for renewing or replacing LPI. Additionally, the New York LPI regulations prohibit the amount of LPI coverage from exceeding the last known coverage amount and prohibit insurers from engaging in several practices, including issuing LPI on property serviced by affiliated servicers, paying commissions, and providing insurance tracking to a servicer or affiliate for free or reduced charge. Six of the states (California, Florida, Illinois, Ohio, New Jersey, and Texas) did not have statutory or regulatory requirements specifically for LPI insurers in connection with mortgages (see table 2).

**Table 2: Summary of Selected States' Regulatory Oversight of Lender-Placed Insurance (LPI) for Real Property, as of 2015**

| State      | LPI-specific laws and regulations |                         | Rate filing method for LPI [Note A]  |
|------------|-----------------------------------|-------------------------|--|
|            | For insurers                      | For creditors/servicers |  |
| California | No                                | No                      | Prior approval   |
| Florida    | No                                | No                      | File and use or use and file   |
| Illinois   | No                                | Yes                     | No filing system   |
| New Jersey | No                                | No                      | No filing system   |
| New York   | Yes                               | Yes                     | File and use based on loss ratio; must file every 3 years or following any year in which an insurer's actual loss ratio is lower than 40 percent |
| Ohio       | No                                | No                      | File and use   |
| Texas      | No                                | Yes                     | File and use   |

Source: GAO summary of information from the National Association of Insurance Commissioners and state regulators and state laws and regulations. | GAO-15-631

Note A: States using the prior approval system review must approve the insurers' rates before they enter the market for sale to consumers. With the file and use system, insurers can use the rates in the market after filing them with the state. With the use and file system, insurers must file rates by a specified time period (such as 30 days) after they enter the market.

<sup>35</sup>NAIC developed a model law for personal property LPI in 1996. Personal property comprises movable goods such as automobiles and can include manufactured homes with a chassis. Real property is fixed and includes land and buildings. In May 2015, NAIC appointed a Creditor-Placed Insurance Model Act Review Working Group to consider updates to the model law and whether real property should be included.

<sup>36</sup>N.Y. Comp. Codes R. & Regs. tit. 11, §§ 227.0-227.8.

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Some states had LPI laws and regulations for mortgage servicers in addition to what the federal regulators required, as the following examples illustrate.

- The Texas Finance Code includes a chapter on LPI, which requires that the creditor (servicer) notify the debtor (borrower) no later than 31 days after the LPI is charged to the debtor.<sup>37</sup> It also provides that a creditor may obtain LPI that will cover either the replacement cost of improvements or the amount of the unpaid indebtedness. The debtor is obligated to reimburse the creditor for the premium, the finance charge, and any other charges incurred by the creditor in connection with the placement of insurance.
- Illinois has a law that applies to servicers using LPI.<sup>38</sup> Specifically, the law requires that notification forms include language similar to the “Notice of Placement of Insurance” forms set out in the act. The notice must be provided within 30 days following the purchase of the insurance. In 2014, the Illinois Collateral Protection Act was amended to provide that a servicer subject to Regulation X that places LPI in substantial compliance with Regulation X would be deemed in compliance with the Illinois law.<sup>39</sup>
- New York has emergency regulations setting out business conduct rules for mortgage loan servicers.<sup>40</sup> Servicers are prohibited from placing homeowners or flood insurance on the mortgaged property when the servicer knows or has reason to know that the borrower has an effective insurance policy. Servicers also must provide written notice to a borrower on taking action to place LPI on a property.

LPI premium rates are subject to different levels of review across states. In most states, LPI is considered commercial lines coverage—that is, the policy is considered to cover the interests of a business (the servicer) rather than a consumer. NAIC officials stated that LPI is usually considered commercial lines coverage because insurers typically sell LPI to the servicer as a commercial product. States can use different rate

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<sup>37</sup>Tex. Fin. Code Ann. §§ 307.001-307.058 (Vernon 2015).

<sup>38</sup>815 ILL. COMP. STAT. ANN. 180/1-99 (West 2015).

<sup>39</sup>2014 Ill. Legis. Serv. P.A. 98-1120, § 5(b) (codified at 815 ILL. COMP. STAT. ANN. 180/40(b)).

<sup>40</sup>N.Y. Comp. Codes R. & Regs. tit. 3, §§ 419.1-14 (2015).

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review systems for commercial insurance, and some states may not have a rate review system for all commercial lines.

According to NAIC officials, state regulators generally review every rate filing for personal lines coverage but may review only some rate filings for commercial lines. The officials told us that state insurance regulators often decided how to allocate resources for rate reviews based on consumer complaints, and personal lines typically generated more complaints than commercial lines. The seven states we selected all considered LPI to be commercial insurance but varied in whether they conducted rate reviews, how they conducted rate reviews, and how often rates were reviewed (see table 2), as the following examples illustrate.

- In New Jersey, commercial lines are subject to the use and file system—that is, the insurers can begin using new rates before filing but must file within a specified period. However, New Jersey does not require insurers to file LPI rates because the state considers it to be a deregulated product.
- In Ohio and Texas, commercial lines are subject to the file and use system, which, unlike use and file, generally allows them to begin using rates as soon as they are filed while the state regulator reviews the filing.
- In Florida, commercial lines and LPI are subject to the file and use system, which as previously noted, requires approval before the rates can be used, or use and file, which allows insurers to use rates as soon as they are filed as long as they are filed no later than 30 days after implementation, subject to refunds if the rates are determined to be excessive.<sup>41</sup> Additionally, Florida requires annual rate filings from its top two LPI insurers.
- In California, commercial lines are subject to the prior approval system, which requires insurers to get state approval before using new rates. For example, after the first filing, California requires property-casualty insurers, including LPI insurers, to refile whenever their rates become inadequate or excessive.

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<sup>41</sup>Florida has a fixed amount of time from the date of filing to approve or disapprove a “file and use” filing. If the state does not approve or disapprove the rate within the allotted timeframe, the rate is deemed approved. Filings for commercial lines other than residential commercial lines, excluding certain lines such as medical malpractice and workers compensation, are made on an informational basis, subject to audit to determine if rates are excessive, inadequate, or unfairly discriminatory.



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- New York uses the file and use rating system for commercial lines. New York also requires LPI insurers to file rates that reflect loss ratios of at least 62 percent and to refile rates following any year in which the actual loss ratio falls below 40 percent. As of 2015, New York required LPI insurers to file rates at least every 3 years.
  - Illinois does not have a rate filing system for all commercial lines.

As with reviews of rate filings, reviews of LPI insurer practices also differed across states. Of the states we selected, those with the highest incidence of LPI were generally the most active in overseeing LPI. According to 2012 NAIC data, California, Florida, New York, and Texas were the top four states in LPI premium volume. Since 2011, three of them—California, Florida, and New York—have reviewed LPI practices in their states in response to increased attention from consumer advocates and NAIC. For example, the New York State Department of Financial Services (NYDFS) took several steps to review LPI practices in its state, which resulted in development of regulations on the LPI activities of insurers and servicers. According to NYDFS officials, the department began an investigation of LPI in October 2011 after receiving complaints from consumer advocates that LPI loss ratios were significantly lower than loss ratios for borrower-purchased insurance. In May 2012, NYDFS subpoenaed LPI insurers and servicers and held public hearings on LPI premiums and the financial relationship between servicers and insurers. In March, April, and May 2013, when NYDFS reached settlements with the four largest LPI insurers, the agency noted in its findings that payments of commissions to affiliated servicers and reinsurance agreements could have led to the high premium rates. The settlements required the LPI insurers to refile premium rates with a permissible loss ratio of 62 percent; to refile rates every 3 years; to annually refile any rates that have an actual loss ratio of less than 40 percent; to have separate rates for LPI and borrower-purchased insurance; and prohibited certain practices, including the payment of commissions. The settlements also required the four LPI insurers to pay restitutions to eligible claimants and pay a combined total of \$25 million in civil money penalties to NYDFS. Additionally, four other LPI insurers agreed to sign codes of conduct implementing New York's LPI reforms. As noted earlier, effective February 2015, New York regulations began addressing several practices, including the use of affiliated insurers, commissions, tracking services, loss ratios, and borrower notification. NYDFS officials stated that since these hearings and settlements, LPI insurers had reduced their rates in New York.

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California's and Florida's actions did not result in revised regulations, but both states did require reduced LPI rates. Officials from the California Department of Insurance said that in March 2012, they contacted LPI insurers and ultimately required four of them to refile their LPI rates. They said that after examining the insurers' annual financial statement data, they found that the insurers' loss ratios were low, and required four insurers to lower their rate schedules. The officials said that these refilings resulted in rate reductions ranging from about 21 percent to 35 percent. Similarly, officials from the Florida Office of Insurance Regulation said that the New York settlements, NAIC hearing, and information from consumer advocates on LPI prompted them to review LPI practices. In July 2012 and May 2013, it held public rate hearings on two of its LPI insurers. Both hearings resulted in orders for the insurers to reduce rates and other reforms, including a prohibition on payment of commissions to the mortgage servicer, borrower notification requirements, and annual rate filings. Florida officials said that the annual rate filings have resulted in rate reductions of about 14 percent and 22 percent for the two insurers. In a 2014 filing, a third LPI insurer agreed to reduce its rates by 4 percent.

According to NAIC data, Illinois, New Jersey, Ohio, and Texas were among the seven states with the highest market share of LPI premiums, but officials from these states stated they have not taken specific actions regarding LPI. Illinois officials stated that although they had not taken actions related to LPI, their market conduct unit was conducting examinations of three LPI insurers and planned to publish the findings in 2015. New Jersey officials stated that in the past 2 years they had received one consumer complaint related to LPI. They added that in general when they receive consumer complaints about any issue, they conduct market examinations and consider regulatory changes if the issue is widespread. Ohio officials said that they had not received consumer complaints related to LPI or identified any issues related to LPI in their state.

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## Federal Regulators Have Long-standing Procedures for Overseeing Servicers' Flood LPI Activities and Are Implementing Recent Regulatory Changes for Homeowners LPI

Federal regulators have recently revised regulations related to flood and homeowners LPI. In 2010, the Dodd-Frank Act amended RESPA to add provisions on homeowners LPI, which CFPB implemented through amendments to Regulation X. Federal regulators have monitored mortgage servicers' flood LPI activities since the 1994 amendments to NFIP. The Flood Disaster Protection Act of 1973 made flood insurance mandatory for properties with mortgages from federally regulated lenders in special flood hazard areas and in communities participating in NFIP.<sup>42</sup> Among other things, the Flood Disaster Protection Act required regulators—including FDIC, the Federal Reserve, NCUA, OCC, the Federal Home Loan Bank Board (FHLBB), and the Federal Savings and Loan Insurance Corporation (FSLIC)—to issue regulations prohibiting lending institutions from approving loans without adequate flood insurance where available. The National Flood Insurance Reform Act of 1994 (1994 Act) included specific provisions on placement of flood insurance by lenders.<sup>43</sup> The 1994 Act also replaced the FHLBB and FSLIC with the Office of Thrift Supervision and added FCA as a regulator for flood insurance compliance, and required the six regulators to impose civil money penalties for patterns or practices of violations of the mandatory flood insurance purchase requirement, including violations of flood LPI rules.<sup>44</sup> The 1994 Act also required regulated lending institutions to notify borrowers of a coverage lapse and to purchase flood LPI on their behalf if the borrower failed to obtain coverage within 45 days after notice. The 2012 Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act) included new requirements for flood LPI, among other items.<sup>45</sup> Like the Dodd-Frank Act for homeowners insurance, the Biggert-Waters Act established rules for refunding flood LPI premiums when the borrower provided proof of existing coverage and clarified that the lender could charge for flood LPI from the date the borrower-purchased insurance lapsed. The act also increased the civil money penalty amounts for

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<sup>42</sup>Flood Disaster Protection Act of 1973, Pub. L. No. 93-234, § 102, 87 Stat. 975, 978 (1973) (codified as amended at 42 U.S.C. § 4012a).

<sup>43</sup>National Flood Insurance Reform Act of 1994, Pub. L. No. 103-325, Tit. V, § 524, 108 Stat. 2255, 2259 (1994) (codified as amended at 42 U.S.C. § 4012a(e)).

<sup>44</sup>The Dodd-Frank Act dismantled the existing federal thrift regulatory structure, abolished the Office of Thrift Supervision, and transferred responsibility for thrift supervision to the banking regulators. Pub. L. No. 111-203, §§ 312, 313, 124 Stat. 1376, 1521, 1523 (2010) (codified at 12 U.S.C. §§ 5412, 5413).

<sup>45</sup>Biggert-Waters Flood Insurance Reform Act of 2012, Pub. L. No. 112-141, § 100244, 126 Stat. 916, 966 (2012) (codified at 42 U.S.C. § 4012a(e)).

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violations of flood insurance requirements and eliminated the per year cap on the amount of civil money penalties for regulated institutions. In March 2013, the regulators published interagency guidance on amendments resulting from the Biggert-Waters Act with a section specifically about flood LPI.<sup>46</sup> In July 2015, the regulators published a joint final rule implementing the provisions of the Biggert-Waters Act related to LPI.<sup>47</sup>

Each of the five financial regulators has adopted flood insurance examination procedures that address flood insurance requirements, including requirements for LPI. Specifically, the examination procedures discuss borrower notification regarding the need to purchase an adequate amount of flood insurance, and as required by statute, provide that if the borrower does not purchase such coverage within 45 days from notification, the lender or servicer will purchase insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance. To enforce the flood insurance requirements, the regulators identify flood insurance-related violations, including flood LPI violations, through their examinations. These examinations are risk based, so examiners may not address all policies and procedures or review flood LPI policies and procedures during every examination. For example, NCUA's examiner's guide states that although they must review flood compliance in every examination, depending on scope, an examiner may review one or more of the following: coverage and internal controls, property determination requirements, LPI requirements, and flood insurance checklists.

Since the amendments to Regulation X became effective in 2014, the five financial regulators and CFPB have been responsible for supervising the regulated entities' activities related to homeowners LPI. Rule-making authority for Regulation X, which implements RESPA, was transferred to

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<sup>46</sup>Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, National Credit Union Administration, and Farm Credit Administration, *Interagency Statement on the Impact of Biggert-Waters Act* (Mar. 29, 2013).

<sup>47</sup>80 Fed. Reg. 43,216 (July 21, 2015). Among other things, the July 2015 final rule amended the agencies' regulations to clarify that a lender or its servicer has the authority to charge a borrower for the cost of flood insurance coverage commencing on the date on which the borrower's coverage lapsed or became insufficient. The final rule also stipulates the circumstances under which a lender or its servicer must terminate LPI coverage and refund payments to a borrower.

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CFPB from the Department of Housing and Urban Development under the Dodd-Frank Act. As discussed earlier, for homeowners LPI, Regulation X, as amended, requires servicers to send two notices to borrowers to confirm that the borrowers do not have the required homeowners insurance before charging the borrower for LPI. Among other requirements, the regulation also prohibits servicers from obtaining LPI if the borrower has an escrow account for homeowners insurance, unless the servicer is unable to disburse funds from the account.<sup>48</sup> Under the regulations, inability to disburse funds does not exist when the borrower's escrow account contains insufficient funds to pay the premiums, but it exists when the servicer has a reasonable basis to believe either that the borrower's coverage has been canceled (or not renewed) for reasons other than nonpayment of premiums, or that the borrower's property is vacant.

Of the five financial regulators and CFPB, CFPB, FCA, FDIC, the Federal Reserve, and OCC have adopted revised examination procedures for RESPA compliance, including compliance with homeowners LPI requirements. NCUA is in the process of updating its examiner's guide and related materials to include the new requirements for homeowners LPI. CFPB's, FDIC's, the Federal Reserve's, and OCC's manuals discuss RESPA requirements for escrow accounts, notifying borrowers, and canceling and renewing LPI, among other requirements. Similar to the procedures they use for flood LPI, examiners also identify violations of homeowners LPI through risk-based examinations of financial institutions.

Because Regulation X's mortgage servicing requirements for homeowners LPI became effective in January 2014, regulators had limited data on the servicers' compliance with them compared to the data on compliance with flood LPI requirements as of May 2015. CFPB officials said that because consumers might not know about LPI until their coverage lapsed, there might be a greater lag in complaint and violations data than there would be for other housing issues. Of the six regulators responsible for enforcing homeowners LPI rules, CFPB, FDIC, Federal Reserve, and OCC had cited violations as of June 2015. The regulators

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<sup>48</sup>Regulation X exempts small servicers (in general, servicers that service, together with any affiliates, 5,000 or fewer mortgage loans; a Housing Finance Agency, regardless of size; or certain non-profit entities) from this requirement if the cost of LPI is less than the amount that will be disbursed from the borrower's escrow account to pay for the borrower's coverage.

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may also impose civil money penalties for servicer violations of homeowners LPI requirements under RESPA and Regulation X, but they stated that as of June 2015 they had not imposed any.

CFPB and several state regulators have reached joint settlements with some servicers for alleged violations of federal and state laws, including some violations related to homeowners LPI.<sup>49</sup> In February 2012, 49 states and the District of Columbia (excepting Oklahoma) and federal government partners reached a settlement with banks and mortgage servicers over similar mortgage servicing violations, including LPI, requiring them to provide \$20 billion in consumer relief and \$5 billion in other payments.<sup>50</sup> In December 2013, CFPB, along with 49 states and the District of Columbia, filed a civil action against a nonbank mortgage servicer alleging misconduct related to servicing mortgages. The complaint identified mortgage servicing violations, including the placement of LPI when the servicers knew or should have known that borrowers already had adequate coverage. In February 2014, CFPB and the states reached a settlement with the servicer, requiring the servicer to pay over \$2 billion to borrowers and to follow certain servicing standards.<sup>51</sup> Additionally, in December 2014, NYDFS reached a settlement with this servicer over mortgage servicing rules, alleging the servicer had conflicts of interest related to LPI, among other violations.<sup>52</sup> CFPB and the same states also reached a joint settlement with another servicer in September 2014 over similar mortgage servicing violations.

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<sup>49</sup>Under the Dodd-Frank Act, CFPB has the authority to take action to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. 12 U.S.C. § 5531.

<sup>50</sup>The National Mortgage Settlement was reached with the Bank of America Corporation, Bank of America N.A., BAC Home Loans Servicing, Countrywide Home Loans, Inc., Countrywide Financial Corporation, Countrywide Mortgage Ventures, LLC, Countrywide Bank, FSB, Citigroup, Inc., Citibank N.A., Citimortgage, Inc., JPMorgan Chase & Company, JPMorgan Chase Bank, N.A., Residential Capital, LLC, Ally Financial, Inc., GMAC Mortgage, LLC, GMAC Residential Funding Co. LLC, Wells Fargo & Company, and Wells Fargo Bank, N.A.

<sup>51</sup>*Consumer Fin. Prot. Bureau v. Ocwen Fin. Corp.*, No. 1:13-cv-02025-RMC (D.D.C. 2014).

<sup>52</sup>*N.Y. State Dep't of Fin. Serv. v. Ocwen Fin. Corp.* (2014) available at <http://www.dfs.ny.gov/about/ea/ea141222.pdf>.

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The consent judgment required the servicer to pay \$540 million to borrowers and to follow certain servicing standards.<sup>53</sup>

FHFA has also taken actions to address LPI concerns (as noted earlier). In November 2013, FHFA instructed Fannie Mae and Freddie Mac to prohibit their servicers from receiving commissions for LPI and from using servicer-affiliated entities to insure or reinsure LPI. Effective June 2014, Freddie Mac prohibits servicers from receiving commissions from LPI insurers, and Fannie Mae requires servicers to exclude from premiums charged to borrowers any commissions received from LPI insurers. Also in June 2014, FHFA's Office of Inspector General (OIG) published a report on FHFA's oversight of LPI and stated that in 2012 the enterprises paid approximately \$360 million in LPI premiums, including, potentially, an estimated \$158 million in excessive LPI rates.<sup>54</sup> The FHFA OIG noted that during a foreclosure, the enterprise that owns or guarantees the mortgage is responsible for the cost of the borrower's unpaid LPI premiums. The OIG recommended that FHFA assess whether the enterprises should pursue litigation against their servicers and LPI insurers to remedy potential damages caused by past abuses in the LPI market. FHFA accepted the recommendation and stated that they completed the assessment in June 2015.

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### Insurer Data for Assessing the LPI Industry Are Unreliable Despite Efforts to Collect More Complete and Consistent Data

Limited reliable data exist at the state and federal levels to evaluate the LPI industry and ensure that consumers are being protected. As part of its efforts to collect financial data on the insurance industry, NAIC updated its Credit Insurance Experience Exhibit (CIEE) in 2004 to require insurers to submit data on LPI to NAIC and state regulators. NAIC and state regulators are responsible for reviewing and analyzing data from insurers, including the CIEE. The CIEE data include information on premiums, claims, losses, compensation, and expenses. However, we determined that these data were unreliable for our purposes.<sup>55</sup> For example, a number of LPI insurers did not submit data to state regulators for CIEE,

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<sup>53</sup>*United States v. Suntrust Mortgage, Inc.*, No. 1:14-cv-01028-RMC (D.D.C. 2014).

<sup>54</sup>Federal Housing Finance Agency, Office of Inspector General, *FHFA's Oversight of the Enterprises' Lender-Placed Insurance Costs* (Washington, D.C.: June 25, 2014).

<sup>55</sup>We had planned to use these data to compare premiums and claims of the LPI industry to that of the borrower-purchased insurance industry.

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as required.<sup>56</sup> Also, data in some states and for some years were incomplete. For example, one company reported data for some states but not for others. NAIC officials stated that another company reported LPI data in the wrong section of the CIEE. NAIC officials stated that they performed some basic reviews and tests to identify data errors, such as significant fluctuation between years related to premiums and claims, and worked with the state regulators to address such issues. However, they said that state regulators were responsible for resolving incomplete submissions, such as ensuring that insurers provided answers for every field. Each state, for example, determines its own policies and procedures for reviewing annual statements, including CIEE data, from insurers. As a result, states may not review and analyze similar levels of LPI data. In addition, NAIC officials stated that in 2013 they updated their data submission instructions to request that the insurers report LPI data separately from the borrower-purchased data. NAIC officials said that state regulators allocate their resources on what they deem to be the most cost-effective activities. LPI is a relatively small insurance line, representing only about 0.1 percent of the overall U.S. insurance industry, but its relatively high premium rates can have a significant impact on affected consumers. Given recent state and federal actions regarding the LPI industry, it has become more important for NAIC and state regulators to have adequate data to effectively oversee the industry. Without more comprehensive and reliable data and adequate policies and procedures to ensure the usefulness of the data, NAIC is limited in its ability to coordinate LPI regulation nationwide, and state and federal regulators lack reliable data about the industry. As a result, they are unable to analyze the relationship between LPI prices and the underlying costs to make sure premium rates are reasonable and cannot ensure that consumers are receiving fair and equitable treatment from the LPI industry.

Recognizing a need to better understand the LPI industry, federal and state regulators have begun coordinating in recent years to collect more detailed data about the LPI industry. FHFA and NAIC officials stated that in 2013 they held discussions about LPI and potential strategies for collecting data to better understand the LPI industry and evaluate whether

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<sup>56</sup>The two largest LPI insurers—Assurant and QBE—did submit CIEE data, but a number of the next largest insurers did not, including American Modern, Great American, and Lloyd's of London. See Birny Birnbaum, *Overview of Lender-Placed Insurance Products, Markets, and Issues* (Washington, D.C.: June 13, 2013).



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recent concerns raised were valid. These discussions resulted in an interagency working group, consisting of state and federal regulators, to discuss LPI. FHFA officials said that in addition to examining the need to obtain more data on the LPI industry, this working group opened a dialogue between several entities, including state regulators, insurers, and servicers. The working group created a template to obtain about 80 LPI industry data variables and tasked a committee with requesting the LPI data (the data call effort). The 80 variables included the type of loan; whether the mortgage had an escrow account; the property's occupancy status; the reason for the coverage lapse; and the company, premium, coverage amount, and deductible for the LPI policy as well as the last known borrower-purchased policy. These data are more granular than what is collected through the annual CIEE in that they include policy-level data that would, among other things, allow for a more direct analysis of LPI premium rates, whereas the CIEE data contain substantially fewer variables and are aggregated at the state and insurer level.

According to NAIC officials, NAIC tasked the Mississippi Insurance Department's Commissioner, chair of NAIC's Property and Casualty Committee, to lead the data call effort. Mississippi officials requested that the top three LPI insurers—which NAIC estimated accounted for about 90 percent of the LPI market—provide the 80 variables. Mississippi officials requested the data in April 2014 for submission by July 2014. However, the insurers and servicers did not submit their final data until December 2014. NAIC and Mississippi officials said the delay was due to the need to clarify data issues with the insurers and correct errors, such as missing fields and missing and outlier values. But the final data lacked values for many of the variables, and some insurers and servicers said that certain information was not available. For example, all three insurers reported annual LPI premium amounts, but only one insurer reported the premium amount of the last known borrower-purchased insurance, and only for some policies. Both of these variables are necessary to determine the difference in cost between LPI and borrower-purchased insurance and understand whether premium rates are reasonable. Additionally, only one insurer reported the lapse date of the borrower-purchased insurance, which would help determine how quickly insurers and servicers are identifying coverage lapses, but this insurer did not consistently report the lapse dates for all policies. According to NAIC and Mississippi officials, one insurer said it did not maintain much of the requested data itself and was unable to get approval from many of its servicers to release the data. As a result, state and federal regulators lack the comprehensive and reliable data necessary to assess LPI industry practices and premium rates and their effects on consumers.

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NAIC and Mississippi officials said that they were surprised that the insurers were unable to produce some of the requested data because much of the data seemed necessary for the insurers to maintain. As a result, NAIC members have opened multistate examinations of the LPI practices of the top two LPI insurers which, among other things, officials expected would help produce the remaining data. As of August 2015, 42 jurisdictions—mostly states—had committed to participate in the examinations, and officials expect to have preliminary findings in the fall of 2015. NAIC is working to address the issue of missing data through the multistate examinations, but it is unclear when such data will be available.

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## Conclusions

Some state and federal regulators have taken action to improve oversight of LPI. However, NAIC and state insurance regulators lack comprehensive and reliable data on LPI premium rates and industry practices to assess their effects on consumers. For example, NAIC has attempted to collect some data aggregated at the state and company levels, but these efforts have yielded incomplete data. Recognizing the need for more robust data on the LPI industry, NAIC and FHFA have coordinated to collect policy- and servicer-level data on LPI. However, LPI insurers and their servicers did not provide all of the requested data. NAIC was created to coordinate insurance regulation across states, and the agency needs quality information to evaluate the LPI industry and the effects of its premium rates and practices on consumers. Although NAIC is working to obtain the missing data, it is unclear when such data might be available, or that its efforts will be effective without additional action. Without more comprehensive and reliable data, state and federal regulators are lacking an important tool to help them fully evaluate the LPI industry and ensure that consumers are adequately protected.

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## Recommendations for Executive Action

To help ensure that adequate data collection efforts by state insurance regulators produce sufficient, reliable data to oversee the LPI market, we recommend that NAIC:

- work with the state insurance regulators to develop and implement more robust policies and procedures for the collection of annual data from LPI insurers to ensure they are complete and reliable; and
- work with the state insurance regulators to complete efforts to obtain more detailed national data from LPI insurers.

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## Agency Comments

We provided a draft of this report to NAIC, as well as CFPB, FCA, FDIC, Federal Reserve, FEMA, FHFA, FIO, FTC, NCUA, and OCC for their review and comment. NCUA provided written comments that we reprinted in appendix II. CFPB, FCA, FDIC, Federal Reserve, FHFA, NAIC, NCUA, and OCC provided technical comments that were incorporated, as appropriate. NAIC officials said they understand the importance of ensuring reliable data and will consider the recommendations as part of NAIC's continuing work in the area, which includes multistate examinations and potential revisions to model laws.

We are sending copies of this report to the appropriate congressional committees and the agencies listed above. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you have any questions about this report, please contact me at (202) 512-8678 or [cackleya@gao.gov](mailto:cackleya@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

Sincerely yours,



Alicia Puente Cackley  
Director, Financial Markets and Community Investment

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# Appendix I: Objectives, Scope, and Methodology

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We were asked to review the lender-placed insurance (LPI) industry and the role of federal and state regulators in monitoring LPI practices. This report (1) describes the extent to which LPI is used, (2) discusses stakeholder views on the cost of LPI, and (3) describes state and federal oversight of LPI.

To address these objectives, we reviewed relevant laws and regulations on lender-placed insurance. We conducted a literature review and reviewed relevant articles, hearings, settlements, and agency guidance on the LPI industry. We also reviewed past GAO reports on homeowners and flood insurance. We interviewed officials from federal agencies, including the Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Department of the Treasury's Federal Insurance Office, Farm Credit Administration, Federal Deposit Insurance Corporation, Federal Emergency Management Agency (FEMA), Federal Housing Finance Agency (FHFA), Federal Trade Commission, National Credit Union Administration, and Office of the Comptroller of the Currency. We selected these agencies because they regulate mortgage servicers' LPI activities or might have an interest in LPI issues. Further, we interviewed officials from the National Association of Insurance Commissioners (NAIC) as well as officials from seven state insurance regulators—California, Florida, Illinois, New Jersey, New York, Ohio, and Texas. We selected these states because they had higher LPI premium volumes and some had taken regulatory action in LPI. In selecting states, we also reviewed publicly available information as well as LPI laws and regulations, whether they had adopted NAIC's model law for personal property LPI and adapted it to real property LPI, whether they had separate banking and insurance offices, and rate approval methods. This selection of states is not generalizable to all states. In addition to the selected states, we met with officials from Mississippi's insurance department to discuss their involvement in NAIC's LPI data request. Finally, we met with four LPI insurance providers of varying sizes, as well as four mortgage servicers, four industry associations, and two consumer advocates. We selected these stakeholders based on their level of involvement in the LPI industry and mortgage servicers to get a mix of bank and nonbank servicers with large and mid-sized mortgage volume. When we refer to "industry officials" in this report we mean officials of the insurance industry associations, insurance companies, and bank and nonbank mortgage servicing companies we interviewed.

To describe the extent to which LPI is used, we reviewed studies, testimonies, and public comments on related regulations to obtain a wide variety of views on how LPI operates. We interviewed the same

consumer advocates, industry associations, and a selection of state insurance regulators, insurers, and mortgage servicers to better understand how each party is involved in LPI and the circumstances surrounding its use. Specifically, we interviewed insurers and servicers to understand their processes for tracking mortgage portfolios, notifying borrowers, and placing LPI. We also interviewed FEMA to understand its flood LPI program—the Mortgage Portfolio Protection Program—and the reasons servicers might choose it versus private flood LPI coverage.

To discuss stakeholder views on the cost of LPI, we interviewed state insurance regulators, consumer advocates, and industry officials about their opinions on the reasons for differences in premium rates between LPI and borrower-purchased insurance and their opinions on the effects on consumers. We reviewed studies, testimonies, and public comments on proposed regulations on flood and homeowners LPI. We obtained premiums and claims data for LPI and borrower-purchased insurance so that these might be compared. We first reviewed NAIC’s Credit Insurance Experience Exhibit (CIEE) database—financial data collected annually from insurers that are aggregated at the state and company levels—with the intended purpose of comparing LPI premiums to those of borrower-purchased insurance. However, we determined that these data were unreliable for our purposes. For example, a number of LPI insurers did not submit CIEE data, and there appeared to be missing data in some years. Further, NAIC officials said that they perform some basic tests on the CIEE data to identify data errors but that state regulators are responsible for resolving incomplete data submissions. We discuss these data issues in greater detail in the report. We also obtained and reviewed data from a data call effort coordinated by NAIC and FHFA that requested policy- and servicer-level data from what they believed to be the top three LPI insurers to get a better understanding of the LPI industry. NAIC and FHFA estimated that these three insurers represented 90 percent of LPI premium revenue in the U.S. However, the total number of LPI insurers as well as the total LPI premium volume are unclear because of a lack of comprehensive national data on the LPI industry. Further, we cannot assume that these three insurers are representative of the other insurers in the industry. Moreover, most of the variables were incomplete for one or more of the insurers. To address these omissions, we limited our analysis to high-level figures summarizing variables that were at least 90 percent complete for each of the top two insurers. We determined that variables where more than 10 percent of the values were missing could produce invalid results. Because of the missing data, we were unable to analyze most of the variables, including those that could have compared

LPI premiums to the premiums of the last-known borrower-purchased policies.

To describe state and federal oversight of LPI, we reviewed and summarized federal laws, regulations, and policies and procedures relating to agencies' enforcement of LPI-related requirements. Further, we interviewed federal agency officials, including examiners and enforcement officials, on flood and homeowners LPI monitoring and enforcement activities. We interviewed insurers, mortgage servicers, and lenders for their perspectives on federal regulations and their enforcement. We reviewed and summarized selected state laws and regulations related to LPI, particularly those related to rate setting, and interviewed NAIC officials and selected state insurance regulatory officials on LPI oversight activities.

We conducted this performance audit from March 2014 to September 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II: Comments from the National Credit Union Administration



National Credit Union Administration  
Office of the Executive Director

August 12, 2015

SENT BY E-MAIL

Ms. Alicia Puente Cackley  
Director  
Financial Markets and Community Investment  
Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Ms. Cackley:

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO) report entitled *Lender-Placed Insurance: More Robust Data Could Improve Oversight* (GAO 15-631). The report addresses the availability of data on lender-placed insurance (LPI) used to protect the collateral on mortgages when borrower-purchased homeowners or flood insurance coverage lapses.

The National Credit Union Administration understands the importance of accurate and timely data to evaluating LPI premium rates and industry practices. We also understand that a lack of comprehensive data limits oversight of the LPI market. The recommendations provided by GAO are designed to enhance the availability of data about this important market. We appreciate the opportunity to comment on the report.

Sincerely,

  
Mark A. Treichel  
Executive Director

OCP/JG  
SSIC 1930

1775 Duke Street – Alexandria, VA 22314-3428 – 703-518-6300

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

Alicia Puente Cackley, (202) 512-8678 or [cackleya@gao.gov](mailto:cackleya@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Patrick Ward (Assistant Director); Christopher Forsys (Analyst-in-Charge); Abby Brown; Emily Chalmers; William Chatlos; Juliann Gorse; Camille Keith Jennings; John Karikari; John Mingus; Patricia Moye; Jena Sinkfield; and Heneng Yu made key contributions to this report.



# Appendix IV: Accessible Data

## Accessible Text and Data Tables

**Data Tables for Figure 1: Numbers of LPI Policies Issued by State, 2013**

Map color divisions

| Number of LPI policies     | States (and District of Columbia)  |
|----------------------------|--|
| 0-49,999 (30 states)       | Alaska, Arizona, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Maine, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon, Rhode Island, South Dakota, Utah, Vermont, West Virginia, Wisconsin, Wyoming |
| 50,000-99,999 (10 states)  | Alabama, Indiana, Louisiana, Maryland, Massachusetts, Missouri, South Carolina, Tennessee, Virginia, Washington  |
| 100,000-149,999 (8 states) | Georgia, Illinois, Michigan, New Jersey, New York, North Carolina, Ohio, Pennsylvania,   |
| 150,000 or more (3 states) | California, Florida, Texas   |

Number of LPI policies (Map data)

| State          | 2013    | 2009-2013 |
|----------------|---------|-----------|
| Florida        | 533,003 | 2,692,834 |
| California     | 233,703 | 1,624,419 |
| Texas          | 198,125 | 936,538   |
| Michigan       | 137,213 | 761,662   |
| North Carolina | 129,031 | 579,446   |
| New York       | 128,411 | 600,982   |
| Illinois       | 126,387 | 633,377   |
| Georgia        | 125,852 | 682,714   |
| New Jersey     | 111,539 | 452,059   |
| Pennsylvania   | 109,652 | 523,410   |
| Ohio           | 100,788 | 544,845   |
| Tennessee      | 74,076  | 368,218   |
| Indiana        | 74,068  | 362,680   |
| South Carolina | 71,313  | 338,810   |
| Alabama        | 70,858  | 357,512   |
| Louisiana      | 60,080  | 322,477   |
| Maryland       | 57,377  | 262,917   |
| Virginia       | 55,022  | 276,641   |
| Massachusetts  | 54,634  | 275,804   |
| Missouri       | 51,547  | 289,462   |
| Washington     | 50,689  | 241,850   |

Appendix IV: Accessible Data

| State                | 2013   | 2009-2013 |
|----------------------|--------|-----------|
| Kentucky             | 49,961 | 229,393   |
| Mississippi          | 45,731 | 236,541   |
| Arizona              | 44,643 | 317,964   |
| Oklahoma             | 40,938 | 203,114   |
| Arkansas             | 40,913 | 213,567   |
| Connecticut          | 38,246 | 163,887   |
| Wisconsin            | 34,985 | 185,562   |
| Minnesota            | 30,509 | 187,550   |
| Colorado             | 29,976 | 161,695   |
| Oregon               | 25,977 | 126,103   |
| Nevada               | 25,231 | 155,937   |
| Maine                | 24,668 | 90,673    |
| New Mexico           | 22,027 | 102,367   |
| Kansas               | 18,539 | 86,421    |
| West Virginia        | 15,394 | 69,049    |
| Iowa                 | 15,335 | 74,205    |
| Utah                 | 13,889 | 76,489    |
| New Hampshire        | 13,247 | 61,518    |
| Rhode Island         | 10,759 | 54,633    |
| Idaho                | 10,487 | 54,463    |
| Delaware             | 10,410 | 48,651    |
| Vermont              | 7,718  | 29,904    |
| Nebraska             | 7,504  | 40,622    |
| Hawaii               | 7,410  | 36,717    |
| Montana              | 5,255  | 25,075    |
| District of Columbia | 4,548  | 22,572    |
| South Dakota         | 3,111  | 16,772    |
| Alaska               | 2,628  | 11,849    |
| Wyoming              | 2,566  | 13,846    |
| North Dakota         | 1,585  | 8,360     |

Sources: GAO analysis of industry data and Map Resources (map). | GAO-15-631

Legend: LPI = lender-placed insurance.

**Accessible Text for Figure 2: Potential Flow of Funds and Parties Involved in an LPI Transaction**

- 1) **Borrower:** Borrower reimburses servicer for LPI premium;
- 2) **Servicer:** Servicer purchases coverage from LPI insurer;
- 3) **LPI insurer:**
  - a) may pay commission to servicer;
  - b) may purchase reinsurance to hedge risk of LPI policies;
- 4) **Reinsurer:** Reinsurance company may be affiliated with the servicer.

Source: GAO analysis. | GAO-15-631

Legend: LPI = lender-placed insurance.

**Accessible Text for Figure 3: Significant Events Related to LPI Oversight, 1973-2015**

- **\*December 1973:** Flood Disaster Protection Act signed.
- **\*August 1992:** Hurricane Andrew hits Florida.
- **\*September 1994:** National Flood Insurance Reform Act signed.
- **\*October 1996:** NAIC issues model law for personal property LPI.
- **2004:** NAIC begins requiring Credit Insurance Experience Exhibit data to break out LPI.
- **\*October 2008:** Emergency Economic Stabilization Act signed in response to emerging financial crisis.
- **\*July 2010:** Dodd-Frank Act signed.
- **October 2011:** New York begins investigation of LPI insurers.
- **February 2012:** U.S. National Mortgage Settlement reached.
- **March 2012:** California announces their review of LPI insurers' loss ratios and request for refiling of rates, ultimately resulting in reduced rates.
- **May 2012:** New York conducts public hearings on LPI, which discuss premiums and the financial relationships between lenders and insurers.
- **\*July 2012:** Biggert-Waters Act signed.
- **July 2012:** Florida holds a public rate hearing on a large LPI insurer, resulting in reduced rates.
- **August 2012:** NAIC holds public hearing on LPI.
- **March, April, and May 2013:** New York enters into settlements with LPI insurers.

- **May 2013:** Florida holds another public hearing on an LPI insurer, resulting in reduced rates and prohibition of commissions, among other reforms.
- **June and August 2013:** FHFA holds LPI working group meetings.
- **November 2013:** FHFA instructs Fannie Mae and Freddie Mac to prohibit servicers from receiving commissions paid for LPI and from using servicer-affiliated entities to insure or reinsure LPI.
- **January 2014:** CFPB's updates to Regulation X take effect and the Dodd-Frank Act provisions related to LPI, among other topics, are implemented.
- **February 2014:** CFPB, along with 49 states and the District of Columbia, reach a joint settlement with a nonbank mortgage servicer over violations, including LPI violations.
- **April 2014:** MID requests data from LPI insurers on behalf of NAIC.
- **May 2014:** Another LPI insurer agrees to reduce rates in Florida.
- **June 2014:** Freddie Mac prohibits servicers from receiving commissions from LPI carriers and Fannie Mae requires servicers to exclude from premiums charged to borrowers any commissions received from LPI insurers.  
FHFA OIG publishes report on LPI and recommends that FHFA assess whether Fannie Mae and Freddie Mac should pursue litigation against their servicers and LPI insurers.
- **September 2014:** CFPB, along with 49 states and the District of Columbia, reach a joint settlement with a bank servicer over LPI violations.
- **December 2014:** New York reaches settlement with a nonbank servicer over mortgage servicing rules, including LPI violations, among other violations.
- **January 2015:** NAIC members open multistate examinations of two LPI insurers.
- **February 2015:** New York regulations prohibiting commissions and other practices take effect.

Source: GAO. | GAO-15-631

Note: Asterisked items are highlighted.

Legend: Biggert-Waters Act = Biggert-Waters Flood Insurance Reform Act; CFPB = Consumer Financial Protection Bureau; Dodd-Frank Act = Dodd-Frank Wall Street Reform and Consumer Protection Act; FHFA = Federal Housing Finance Agency; LPI = lender-placed insurance; MID = Mississippi Insurance Department; NAIC = National Association of Insurance Commissioners; OIG = Office of Inspector General.

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**Accessible Text for Figure 4: LPI Insurer Tracking and Notification Process**

- **100%** loans with policies due for renewal;
  - Insurer uses electronic tracking system to identify loans being at risk of potential lapse;
- **About 14%** of loans initially without evidence of coverage;
  - **About 2 weeks prior to expiration:** Insurer contacts borrowers' insurers, insurers' agents, and borrowers to find proof of coverage;
- **About 9%** of loans receiving first letter;
  - **Around expiration:** Insurer/servicer sends first letter to borrower asking for proof of coverage;
- **About 3%** of loans receiving second letter;
  - **About 30 days after expiration:** Insurer/servicer sends second letter;
- **About 1%-2%** of loans on which an LPI policy was issued;
  - **About 60 days after expiration:** Insurer issues LPI policy.

Source: GAO analysis of information provided by insurers. | GAO-15-631

Legend: LPI = lender-placed insurance.

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## Agency Comments

### National Credit Union Administration

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**Accessible Text for Appendix II: Comments from the National Credit Union Administration**

National Credit Union Administration  
Office of the Executive Director

1775 Duke Street  
Alexandria, VA 22314-3428  
703-518-6300

August 12, 2015

SENT BY E-MAIL

Ms. Alicia Puente Cackley  
Director  
Financial Markets and Community Investment  
Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Ms. Cackley:

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO) report entitled *Lender-Placed Insurance: More Robust Data Could Improve Oversight* (GAO 15-631). The report addresses the availability of data on lender-placed insurance (LPI) used to protect the collateral on mortgages when borrower-purchased homeowners or flood insurance coverage lapses.

The National Credit Union Administration understands the importance of accurate and timely data to evaluating LPI premium rates and industry practices. We also understand that a lack of comprehensive data limits oversight of the LPI market. The recommendations provided by GAO are designed to enhance the availability of data about this important market. We appreciate the opportunity to comment on the report.

Sincerely,

Signed by  
Mark A. Treichel  
Executive Director

OCP/JG  
SSIC 1930

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