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CONSUMER FEDERATION CALLS FOR END TO MASSIVE KICKBACKS, EXCESSIVE PRICES FOR FORCE PLACED INSURANCE

New York -- As a New York investigation of "force-placed" insurance abuses widened, the Consumer Federation of America (CFA) today called on state regulators to end insider dealing by insurers and lenders and to bring down the unjustifiably high home insurance rates charged to some consumers. Testifying before the New York Financial Services Department, CFA Insurance Director J. Robert Hunter urged New York to become a national leader in overhauling regulation of force-placed insurance (FPI).

FPI policies are placed by banks on borrowers' property, if borrowers fail to keep hazard insurance in force. This usually occurs because they fall behind on paying the policy premium. Because of the recent tough economic and housing situation, many more policies have become force-placed. One of the biggest insurers in New York now has more than 33,000 FPI policies in effect.

"Lenders usually use forced insurance as an opportunity to collect vast profits by charging outrageously high rates," said Hunter, a former Texas Insurance Commissioner and Federal Insurance Administrator. "Self-dealing and kickbacks are common. Lenders collect commissions through affiliated agents or brokers. They receive below-cost or free services from insurers, such as loan tracking assistance. Or they use an insurance company as a front to direct the coverage – and the profits – to their affiliated reinsurers," said Hunter.

Hunter identified "reverse competition" as the major problem with the FPI marketplace. This phenomenon occurs when insurers compete for lenders' business by providing financial incentives to the lender, which are then charged to borrowers, increasing the cost of the insurance.

"Reverse competition is a market condition that drives up prices to the consumers, as opposed to normal competition, which usually brings rates down," Hunter said.

In a review of rate filings in New York, CFA found that there is virtually no competition. The major FPI insurance companies, Assurant and QBE, charge the same rates. While these companies claimed that they would pay out 55 to 60 percent of premiums they received to cover losses, they in fact only paid out 25 to 30 percent.

"The exceedingly low payouts for FPI insurance means that New Yorkers are being charged far too much for the coverage," Hunter said.

Hunter testified that reverse competition abuses fall into the cracks between insurance and banking regulation. Looked at purely from the insurance regulator's perspective, FPI is commercial insurance between a sophisticated seller (the insurance company) and a sophisticated buyer (the lender or servicer). In addition, the expenses that occur because of reverse competition are real, but they mask the payments (hidden rebates) that lenders receive. Overt rebates are illegal in New York and almost every other state.

"Just like insurance regulators, state bank regulators have done little to stamp out FPI abuses," said Hunter. "They often see this as only an insurance issue, which means that it is someone else's problem. Besides, what could be better for safety and soundness than the huge profits FPI generates?"

By contrast, New York's Financial Services Department oversees both insurance and banking, which means that the state is well-suited to investigate problems with FPI insurance, which affect both insurance and lending regulation.

Hunter presented data demonstrating that the lack of underwriting by FPI insurers only explains, at most, a small fraction of the higher prices insurers charge for FPI. (Underwriting involves evaluating the risk that consumers will neglect or damage the homes that are being insured.) According to CFA's analysis, if an insured New Yorker can't pay his or her homeowner's insurance premium and is thus force-placed, the expected payouts in losses per-dollar-of-premium drops sharply from 62.7 percent for the average industry homeowners' policy in recent years to 24.0 percent for American Security and 18.3 percent for Balboa, the major FPI insurers in New York.

If a homeowner being force-placed were paying a rate of $1,000 for the average industry homeowners' policy, his or her expected losses would be $627.00. However, in order to cover the same $627.00 for claims payouts, American Security would require a premium of $2,612.50 and Balboa would require $3,426.23.

"Approval of rates charged by a FPI insurer to lenders by New York should not be seen as approval of what lenders can charge borrowers. The amount a borrower pays for FPI should be only that which is reasonably necessary to cover the risk, expenses and profit of that individual's insurance and not cover insurer kickbacks to lenders," said Hunter.

<u>Suggestions for Reform</u>

CFA has written all state insurance commissioners urging them to take several steps to reform the FPI market and to help struggling homeowners afford insurance:

1. **Use escrow to keep voluntary coverage in place.** If a lender needs to maintain property coverage because a borrower has not paid his or her insurance premium, lenders should use the escrow (or set up escrow if it is not in place) to pay the original insurance carrier, rather than forcing the borrower to pay for a new, higher priced policy.

2. **Eliminate or substantially reduce kickbacks**. CFA recommends requiring a minimum loss ratio as the best way to control the adverse consequences to consumers of reverse competition and prevent overcharges. However, to be meaningful, such a loss ratio must be vigorously enforced. Insurers did not come close to realizing the loss ratios they claimed they would meet in New York. CFA recommends a minimum loss ratio for FPI should of 80 percent, which means that for every dollar that borrowers pay for insurance, 80 cents must be paid out of the insurer to cover losses.

3. **Require insurers to immediately submit FPI rate information**, if a minimum loss ratio is not used and enforced. Once this happens, regulators should conduct a complete statistical and actuarial analysis of this rate information and prohibit insurers from passing on kickbacks and other unjustified charges to consumers.

The Consumer Federation of America if a nonprofit association of nearly 300 consumer groups that was founded in 1968 to advance the consumer interest through research, advocacy, and education.