Insurance Recovery & Advisory
Finance
May 16, 2013

Federal Housing Finance Agency Proposes New Rules on Lender-Placed Insurance

By Robert Wallan

On March 29, the Federal Housing Finance Agency (FHFA) proposed consideration of new regulation on lender-placed insurance. The FHFA specifically requested public input concerning sales commissions and reinsurance activities, but indicated that it plans a broader review of issues relating to the market for lender-placed insurance. Lender-placed insurance has long raised regulatory and litigation concerns, and the prospect of new FHFA regulation impacting Fannie Mae and Freddie Mac is an issue lenders will want to consider.

What is lender-placed insurance? In real estate lending transactions, standard loan documents obligate the borrower to maintain hazard insurance on real property improvements. If the borrower fails to maintain adequate insurance on that property, the lender is authorized to “force place” insurance to protect the interests of the lender on the property securing the loan. In the area of automobile loans, this type of insurance is typically called “collateral protection insurance,” or “CPI.” In connection with loans secured by real property improvements, the terms used are “lender-placed insurance” or “force-placed insurance.” In either case, the lender purchases the insurance and then adds the premium to the balance of the loan, effectively charging the borrower. Often, the lender outsources the administrative effort of tracking which loans have adequate insurance in place. Sometimes lenders arrange to directly or indirectly receive commissions for placing such insurance.

Lender-placed insurance typically covers only the collateral, meaning that the physical structure of a house will be insured, but not its contents. In contrast, typical homeowners insurance will extend protection to both the structure as well as its contents. In addition, privately purchased homeowners insurance may also extend to provide liability coverage.

When a borrower has no equity in a property, he or she might be less inclined to care for and protect the property. Lender-placed insurance is typically not underwritten on an individual basis, and in general the risk to the property associated with a defaulted borrower is higher than the risk associated with a nondefaulted borrower. The result is that a borrower with lender-placed insurance typically pays more premium dollars for less coverage.

Litigation Exposure. While lenders have a right to protect uninsured collateral, the practice of lender-placed insurance was the subject of numerous class actions in the 1990s, and is again becoming a focus. The main arguments against lender-placed insurance involve **commissions, tracking service fees, over-insurance, notice and disclosure issues, backdating, pricing and interest charges,** and **statutory limitations**, among others. In March of this year, Governor Andrew Cuomo of New York announced a $14 million settlement with Assurant, one of the largest providers of force-placed insurance. Most banks active in the home loan business have faced lender-placed class action lawsuits at some point.

Statutory Limitations. The large majority of states impose some form of regulation on lender-placed insurance. One example in California is Civil Code section 2955.5, which prohibits a lender from requiring insurance that exceeds the replacement cost of the improvements on the property. CPI issues have also been addressed via a Model Act adopted by the National Association of Insurance Commissioners, and adopted in varying forms by many states.

FHFA next steps. The FHFA plans to accept public comment through May 28, and then move forward on appropriate action with respect to sales commissions and reinsurance premiums. More litigation and regulation impacting lenders, borrowers, and insurers on lender-placed insurance seems certain.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the author.

Robert L. Wallan (bio)
Los Angeles
+1.213.488.7163
robert.wallan@pillsburylaw.com