

Hello, my name is Joseph Markowicz and I thank you for the opportunity to address the NAIC about my exposure to Lender-Placed Insurance over the years. First, I would like the opportunity to share some information about my background, particularly as it relates to working closely with lender-placed insurers over the past 20 years and then take some time to elaborate on their connection to mortgage lending institutions.

After extensive exposure to hazard insurance policies that provide coverage on the insurable interest(s) of mortgage banks, I have accumulated special knowledge on coverage aspects of the LPI product, particularly as it relates to insurance claims submitted to lender-placed insurance carriers.

In 1992, I presented a new approach to mortgage lenders to examine each defaulting property in their loan servicing portfolio to identify damage(s) and then, when applicable, refer losses to insurers and recover insurance claim proceeds on the lender's behalf. This niche primarily centered on foreclosed properties that become real-estate owned properties owned by mortgage banks.

As you know, the Lender's Loss Payable Endorsement accompanies each loan originated by a mortgage bank. This document, also known as Form 438BFU, outlines the semantics of the relationship between lenders and insurers on properties that are added into the loan portfolio of a loan servicer.

While reading this document in the early 90s over and over, I saw that lenders had a certain right in their relationship with insurers that did not appear to be exercised by any mortgage banks at the time. In the 438BFU and the New York Standard Mortgage Clause, it stipulated that mortgagees/lenders had certain insurance rights that provided coverage when damage was inflicted by their own mortgagor/borrower.

I helped the mortgage lending community understand an oversight exists where, according to the Form 438BFU, Section 2 in this document, it stated that mortgagees could pursue the recovery of insurance claims from damages that were directly caused by their mortgagor.

As time has told us over the years, there generally is a 15% chance that some form of damage is inflicted to the bank's REO property that would result in an insurance claim, most often as a result of vandalism and theft.

Other times, you may find a borrower who incurs a major fire on their property one night before the foreclosure date that would, coincidentally, result in a large loss draft. Up to this point in 1992, banks would submit hazard insurance claims on fire losses and other large-scale damage with major losses.

At this time, I saw an opportunity to take the concept of examining each property in a lender's REO portfolio and search for damages directly ourselves, particularly during the window of time immediately after foreclosure and/or eviction in the REO cycle.

In presenting this new option to the lending community, PRPclaims became the first company to directly search and identify damages and began referring a growing amount of theft and vandalism claims to insurers. This also included many other claims resulting from fire damage, wind damage, freeze damage, etc. and other perils in their all-risk policy, often called a fire policy, with insurers.

Now, going back to the early days in the early-mid 90s, it was a very different landscape within the realm of insurance carriers who provided hazard insurance coverage to lenders. At that time, there were a lot more insurance claims going to standard insurance carriers (State Farm, Allstate, Farmers, etc.) and the lender-placed insurance industry was a lot more fragmented with multiple carriers.

In the early-mid 90s, about 70% of our early claims went to standard carriers, where only 30% of early claims went to LPI carriers. At this time, the standard insurance carriers were accustomed to claims coming in from homeowners on property damage occurring throughout the country.

A steady stream of damage referrals on behalf of the lender began to appear to standard insurance carriers in 1992, and then quickly began to multiply. As you can imagine, there was quite a lot of initial resistance to "bank claims" in the beginning from insurance carriers. The struggle began on our side to educate insurance carriers on the rights of the mortgage lenders.

One by one, we had to convince insurance carriers that the bank did, in fact, have coverage in place that covered losses caused by the mortgagor (as stipulated in the Lender's Loss Payable Endorsement, Form 438BFU and the New York Standard Mortgage Clause). Little by little, this new approach began to get accepted by insurance carriers and a bridge was built to better connect lenders to insurers that streamlined the interaction between the two in referring damage that was covered by the lender's hazard insurance policy.

As a result, hundreds of thousands of dollars began to be returned to lenders from a new outlet for monies gathered in "recovery". Loss severity was proven to be substantially reduced and the concept of maximizing "bank claims" on an REO portfolio quickly spread among the majority of portfolio lenders.

As momentum continued to build in the mid 90s, I took this concept to the GSEs for an initial pilot test to apply on their CA portfolio. Once proven successful, we were assigned to build the first national recovery programs for Fannie and Freddie on their nationwide portfolio.

Over the past twenty years, this bridge between lenders and insurance carriers produced tens of millions of dollars from recovered claim proceeds for the lending community and quickly became an established standard of default loan servicing.

In the interest of providing a broad-brush overview on the analytics of insurance claims, on a conventional loan portfolio with A paper, you generally would have an insurance claim on 1 out of every 8 properties (about 12%). On a subprime loan portfolio, you would find a higher probability of damage and would have an insurance claim on 1 out of every 6 properties (about 16-18%). The median amount on loss drafts collected from an insurance claim is usually somewhere between \$4,200 - \$4,400.

Now going back to 1995, I was asked by California's Dept. of Insurance to give testimony during a hearing for CA Insurance Commissioner John Garamendi where questions were asked about these new bank claims, as well as the relationship between mortgage lenders and insurance carriers, particularly on the "Unfair Claims Settlement Act". During these hearings, there were also extensive discussions about the insurer's premiums, cost of tracking, letter campaigns, etc. and whether each were justified.

Since then, I feel like we've come full circle in asking the same questions. Over the past 5 years, we've experienced the most dramatic sea change in the default loan servicing environment. However, when it comes to insurance that covers defaulting loan assets, the same questions are being asked today, it appears that "the more things change, the more they stay the same".

Members of the NAIC, I wanted to thank you for the opportunity to address your members and share my thoughts at this hearing on the Lender Placed Insurance product and address 3 underlying questions at this time:

- 1) "Is insurance in general really necessary for lenders to have coverage in place up to the foreclosure date, as well as carrying an REO policy up to disposition of the loan asset (versus the option of self-insuring)".
- 2) "If this insurance is deemed necessary, is the best coverage available coming from the lender-placed insurance product?"
- 3) Could an evaluation of the Lender-Placed Insurance product in regard to the correlation between claims to premiums be used to help control costs of premium for borrowers and the general public?

After two decades of direct exposure to identifying damages across a loan portfolio and observing the extent of claim proceeds recovered over the years, I believe it is imperative for mortgage lenders to have some form of insurance policy in place through the entire default cycle (from Notice of Default to the Foreclosure Date, as well as all the way to REO disposition).

Due to the inherent need to have protection that covers any unexpected event that can occur from external sources (squatters, vandals, natural disasters), lenders need to have some form of insurance in place that protects this collateral. However, even more important is to have coverage in place that may result from the acts of the borrower upon their exit from a foreclosed property.

Self-insuring is an option to consider but, from my perspective in calibrating the risk exposure to the lender out on the front line and in the field, I truly believe that insuring the lender's interest in these properties is definitely a necessary and integral part of loan servicing. The risks inherited by self-insuring carries too great of a volatility risk. Ultimately, I believe the loss severity would outweigh the savings from premium.

To broaden the question to include "is lender-placed insurance necessary and an acceptable option for coverage?", I would have to conclude that lender-placed insurance is an acceptable form of protecting collateral for loan servicers on the loans they service on behalf of the issuers of residential mortgage-backed securities.

In the interest of being candid and forthright, I have not had much exposure at how the LPI product affects the general public, since we have yet to ever have any involvement or interaction with the general public. However, I have gathered unique insight on the relationship between LPI carrier and lender and wanted to share some thoughts to explain how the LPI product affects mortgage lenders in their default servicing activities.

Since the default climate began to greatly change for lenders beginning in late 2007, a stronger alliance and tighter relationship has been cultivated between loan servicers and LPI carriers. Although LPI has become a lot more scrutinized the past couple years, this relationship has proven to control losses for RMBS issuers and represents an acceptable option for insuring defaulting properties in a lender's loan portfolio.

Companies like American Security and QBE protect the interest of RMBS investors. These investors rely on loan servicers to protect their collateral. Then, loan servicers rely on LPI carriers to protect their interest. This has made the relationship between loan servicers and LPI carriers extremely tight with high levels of interdependence.

Although premium costs are a lot more expensive than other alternatives that could be evaluated, I believe the premiums of the LPI product justify the risk incurred, as well as the administrative costs undertaken by the LPI carrier on the lender's behalf, that are bundled into the costs of premium.

In the 90s when I began this outsourced industry for hazard insurance claims, portfolio lenders were much more prevalent and the securitization of loans had yet to begin. Portfolio lenders were much more concerned about their bottom line and recognized the need for adding more recoveries to offset the losses on their defaulting properties.

During this era, the conforming conventional loans (secured by Fannie & Freddie) required impound accounts. These impound accounts reduced the reliance on an excess

policy supplied by LPI because there were reserves in place for insurance premiums to be paid should a borrower start down the path towards default and foreclosure.

Once mortgage lenders like Countrywide and Ameriquest began to grow very quickly with adding new products in underwriting for loan origination, particularly on the subprime side, the importance of requiring and maintaining impound accounts soon began to fade.

As you know, the subprime industry and the securitization of loans gained a lot of momentum from 2001 – 2007 at an unprecedented pace. Once Fannie and Freddie also went down the path of subprime loans, the volume of loans with impound accounts in place quickly began to diminish across the country.

Once the housing bubble began to burst towards the end of 2007, the saturation of LPI product began to spread across a lender's portfolio. Consequently, a stronger reliance on the LPI product began to form, growing into an extremely strong relationship between LPI carrier and loan servicer.

Since portfolio lenders who owned the paper started to diminish and gradually become extinct due to the securitization of loans that quickly became the norm. The industry underwent drastic changes and the initial role of "lender" converted into the role of "loan servicer".

Within this new securitization format, loan servicers were required to recover insurance claim proceeds on behalf of RMBS issuers. However, the loan servicer does not have anything directly at stake anymore as recoveries are now "passed back up the line" to another entity.

This function converted into a much lower level of importance at the operational level and loan servicers developed very little interest in maximizing the recovery of claims. As, one loan servicer told us, claims recovery has a 0 value to them.

On the other hand, the cost of processing hazard insurance claims is costly to insurance carriers. For each claim submitted, an insurer is going to incur approximately \$1,000 in various expenses to process the claim. This expense is unaffected by whether the claim pays anything or is even considered a valid claim.

As the current model operates today, these expenses tend to keep the premium costs high as these administrative costs in the field are also bundled into their premiums (which also includes the administrative work of the letter campaigns and tracking services provided to the loan servicer).

In evaluating the LPI product to optimize the correlation between claims to premium, it appears that LPI carriers have been incurring many excess costs in processing claims which can be better controlled that may lead to passing these savings into a reduction of the cost of LPI premiums for the general public.

We share the commissioner's concerns about lender placed insurance and have developed some alternative services that include cutting out the middlemen that will help LPI carriers lower their costs in processing claims. We also have been researching alternatives to the need for lender placed insurance in general.

We thank you for the opportunity to share our thoughts and are here to help to the extent that we can and appreciate the dialogue that the NAIC has opened regarding lender placed insurance.