SERVICING MANAGEMENT®

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Insurance Rates Soften As Supply Side Expands

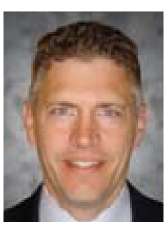
From a cost perspective, an inflow of new insurance companies and fresh capital is putting downward pressure on rates for properties in non-catastrophic areas.

by John Clapp

Force-placement of insurance - long-standing servicer function though it may be - is not without its share of complexities, nor is it immune to the market forces that define shops' loss mitigation strategies.

Every mortgagor is obligated to insure his or her property. While a lack of insurance can technically trigger a foreclosure, no servicer is eager to take that tack. Instead, servicers wish to work with borrowers to identify the root cause of a policy lapse, bridging gaps with force-placed coverage where necessary.

Insurance lapses occur for multi-farious reasons, ranging from the benign (an uncoordinated switch from one homeowners policy to another) to the malevolent (a borrower's shell game with the lender). Lender-placed coverage is also unavoidable in certain cases, such as an occupied property in Florida that carries a homeowners policy but no wind policy (commercial carriers are increasingly gun shy of this peril).


Vermost

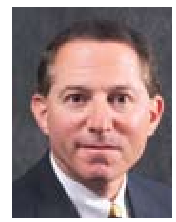
While unemployment and underemployment are sustaining high foreclosure levels, they are also causing borrowers to reprioritize their bill payments. In the event that homeowners insurance is among the first to go, collateral is left unprotected. Upside-down borrowers, before going to the extremes of strategically defaulting or walking away from their properties, often consciously decide to let their policies lapse. These voluntary forfeitures of insurance make up a portion of the increased lender-placed activity.

"If borrowers are behind on the house - if they weren't escrowed - odds are, they didn't pay that insurance renewal either," says Craig Vermost, senior vice president with Lee & Mason Financial Services. Many servicers are moving from blanket policies to an insurance-tracking environment, he says, noting that some clients are essentially "splitting the shop" - tracking insurance on first mortgages but keeping blanket mortgage impairment on second-mortgage portfolios.

Banks' real estate owned (REO) inventories, meanwhile, are bulging, necessitating not only coverage, but also resulting in higher volumes of claims to report. Carriers' risk appetites vary, although there are certain scenarios that no carrier finds attractive (e.g., an REO in Detroit, where vandalism claims are high).

From a cost perspective, an inflow of new insurance companies and fresh capital is putting downward pressure on rates for properties in non-catastrophic areas. Servicers welcome this softening, as well as the new market entries' willingness to insure even the most exposed portfolios at low rates. More conservative carriers, however, suggest that actuarial studies and historical data do not support such aggressive pricing strategies.

"I have seen the newer players being a little more flexible with underwriting, because they haven't had the experience that some of the more seasoned underwriters have had," says Lee Brodsky, president of JMB Insurance, adding that established providers "have very specific philosophies of what they like and what they don't like."


Brodsky

Though more carriers are writing REO books of business than previously - creating an environment of attractive rates - there is a trade-off from the servicer's perspective.

"Some of the new players have really good rates, but they don't have the experience of handling REO and force-placement - and it's been painful, from a billing standpoint, to get these things worked out," Brodsky continues, saying there is sometimes confusion regarding the length of time a property is on an insurer's schedule.

Tracking

As the frequency of force-placed policies increases, servicers might consider outsourcing the workload - from tracking to borrower contact, to eventual policy placement. Many large shops, realizing the economies of scale involved, have already taken this step. Community banks, citing compliance needs, are now following suit, Vermost says.

"Everything is very compliance-driven right now," he says, referring, in part, to Home Ownership and Equity Protection Act escrow requirements for high-yield loans that kick into effect in April.

Rick Pedack, president of Seattle Specialty Insurance Services Inc., agrees that smaller financial institutions' decisions to leverage vendors' tracking capabilities are influenced by regulatory concerns more than by volume. Regardless of a community bank's portfolio size, any properties that are in flood zones must be covered against that particular peril.

"Blanket coverage is popular for some smaller institutions. However, you still have a federal regulation to track and force-place flood insurance," Pedack says. "So if you're going to do that anyway, you might as well be tracking hazard and have the individual that fails to get the coverage pay the freight. From that perspective, you could write blanket coverage, but how are you going to allocate the costs?"

Before handing their insurance duties to third parties, servicers are, of course, conducting very detailed due diligence of potential vendor partners. Information security, internal controls, and report-generation and system-interface capabilities are givens in any vendor-review process. Service-level agreements for insurance work may also include parameters around service providers' abandonment rates, hold times and first-call resolutions.

Once a vendor has been tapped for tracking services, servicers often request data on document processing; the number of escrowed accounts paid to date; the number of lender-placed policies, segmented by coverage (e.g., fire, flood, wind); and the percentage of policies placed versus the number of loans tracked.

"[Servicers] want to know you have tight quality-control processes in place," says Mike Cox, senior vice president of lender services for Proctor Financial Inc. "The last thing they want to happen is to have a borrower become upset because of an error in tracking and then have the borrower try to escalate that dissatisfaction up the ranks of the lender."

A traditional servicer might force-place coverage on 0.5% to 3% of its portfolio, whereas penetration rates typically grow to 5% to 11% for subprime portfolios, Cox says. Still, most blips on the insurance radar do not result in a servicer's force-placing a policy.

Larry Cason, president of the IL Group, estimates that, out of a typical 100 situations that arise, only about 20% to 30% end up in lender-placed insurance. "We go to great lengths to explain the problem to borrowers," he says. "Every lender we have subscribes to full disclosure. We want the borrower to know what's happening, why it's happening and actually encourage them to get their own insurance, if they can."

Once an exception is spotted, it is up to the tracking agent - in-house or outsourced - to determine why the lapse occurred. The most common approach is to first put in a call to the borrower's previous insurance agent and/or carrier of record. Borrowers are only contacted directly as a matter of last resort.

"It varies by each of the servicers, but the components are somewhat similar," says Mark Schmitt, vice president of underwriting and compliance with Assurant. The company usually begins its data gathering about 30 days before a borrower's homeowners policy is set to expire, continuing for about 60 days before the force-placed policy is issued.

"Part of the objective is not to write a bunch of insurance," adds Pedack. "The objective is to encourage the borrower to secure their own insurance…because it will provide a better measure of coverage than force-placed can." SM