

## Chapter 1

# The Beginning and How We Got Where We Are Now

### 1.1 The Beginning

The worldwide economic crisis, which in the United States began in 2007–2008 is often called the Great Recession. It has proved to be the greatest financial devastation since the Great Depression. Many books, articles, and reports have been written about its causes and effects.<sup>1</sup> Mortgage practices have received their share of attention in short newsletters and in the popular press.<sup>2</sup> Indeed, there seems to be little to add to how the Great Recession came about and its effects.<sup>3</sup>

This book focuses on one aspect of that national financial turmoil: lender force-placed insurance (LFPI or simply FPI). The facts presented here were accumulated through investigation concentrating on publicly available information contained in exhibits to pleadings unsealed in electronic court files, officially reported and also unreported judicial decisions, depositions, interrogatory answers, allegations in complaints, and answers filed in cases including LFPI cases. Enough information has been made public to allow the observations that follow about the business practices that have been followed and also to allow reporting of the allegations that resulted. Some information has been deliberately kept secret by agreements in all of the lawsuits that have been investigated since research and writing of this book began three years ago,<sup>4</sup> but there is still enough information available from public records to display the outlines of the LFPI story.

These secrecy agreements are clearly suppressing the story of LFPI business practices. Ordinarily it is too difficult to pursue an investigation of the available sources except through litigation. Since LFPI business practices affect every person who owns a home, it is reasonable to expect that LFPI business practices would be open to view, but that is far from the case. These business practices are kept hidden from view in most cases.

LFPI practices, though often overlooked, are still only one aspect of the Great Recession. They offer a lens through which one may look at many previously unclear or obscured facts about the Great Recession. Regarding mortgage-making in particular, a fraud specialist testified to the Financial Crisis Inquiry Commission that “the definition of a good loan changed from ‘one that pays’ to ‘one that could be sold.’”<sup>5</sup> The commission’s investigation showed that this new business model changed the practices in making mortgage loans that had previously been followed for decades:

The time-tested 30-year fixed rate mortgage, with a 20% down payment, went out of style. There was a burgeoning global demand for residential mortgage-backed securities that offered seemingly solid and secure returns.

\* \* \*

When originators made loans to hold through maturity—an approach known as *originate-to-hold*—they had a clear incentive to underwrite carefully and consider the risks. However, when they originated mortgages to sell, for securitization or otherwise—known as *originate-to-distribute*—they no longer risked losses.<sup>6</sup>

Mortgage indebtedness in the United States doubled from 2001 to 2007. During that same period, mortgage debt rose almost as much as it had since the United States was founded as a nation. The average amount of mortgage debt for each household in the United States rose by nearly \$60,000 during those six years. “[I]t soon became apparent that what had looked like newfound wealth was a mirage based on borrowed money.”<sup>7</sup>

LFPI premiums are a part of this mortgage business model and are added to monthly mortgage payments. If the LFPI premiums are not paid

like every other charge included in the monthly mortgage payment, the mortgagee (the party holding the right to receive the mortgage payments) can declare a default and foreclose.<sup>8</sup> “[I]n the event of foreclosure, costs are passed onto investors.”<sup>9</sup>

Add-ons that drive up the LFPI premiums, such as kickbacks from insurance companies that provide force-placed insurance to lenders and servicers that obtain it at the expense of the borrowers, may be a tipping point for any homeowner’s budget.

What is at stake is billions of dollars taken from homeowners.

In addition, homes can also be taken from homeowners because of the kickbacks imposed in LFPI premiums force-placed on the borrowers for insurance that does not usually provide them any protection; LFPI ordinarily protects the lenders and not the borrowers.

## 1.2 Where We Are Now

Lender force-placed insurance once was dealt with under previous concepts of collateral protection insurance, insurance meant to protect a lender’s collateral.<sup>10</sup> It now means other things to many lenders and servicers and the insurance companies providing force-placed insurance, such as kickbacks, commissions, a cut of the deal such as a reinsurance premium, and a payment even when lenders have not established their own subsidiary agencies for taking commissions.<sup>11</sup> These other previously unpublicized payments have collectively been described as part of a “reverse competition” to generate higher prices for LFPI policies instead of lower LFPI premiums.<sup>12</sup>

Under this new and different business model that has supplanted the business model previously known to borrowers, banks, courts, and people in general, the idea that a borrower can any longer walk away from one mortgage offer and find another improved mortgage loan offer elsewhere is theoretical. It simply does not match the current realities of mortgage financing, if it ever did. The evidence confirms that, to the contrary, borrowers are not experienced in comparison shopping when it comes to financial products such as mortgages.<sup>13</sup>

Yet even if borrowers are experienced in comparison shopping for mortgages, there is no available comparison and thus no shopping is possible. The same uniform mortgage instruments in use throughout the United States to this day are prepared by Freddie Mac and approved by Freddie and Fannie Mae, the two government-sponsored entities that address mortgage documents, both of which are now in conservatorship under the direction of the Federal Housing Finance Agency.<sup>14</sup> The mortgage documents and their uniform provisions are discussed in the next chapter.

The remaining chapters of this book address the most significant issues involved in LFPI business practices, claims, and defenses alleged and testimony given in the resulting lawsuits; the sometimes-surprising responses and interpretations of federal courts and agencies; and possible solutions addressing these issues and the problem of allegedly excessive attorney's fees awards as a reason for denying access to courts.

## Notes

1. There are so many publications that address the causes and effects of the Great Recession that it is not possible either to cite them all or to prevent inadvertent injustice by not listing particular publications. This list is thus meant to be a representative sample, beginning with judicial opinions, then continuing with reports authored by government commissions and officials, and finally moving on to comments published by private sources. *E.g.*, *Freidus v. Barclays Bank PLC*, 734 F.3d 132, 135–37 (2d Cir. 2013); CONGRESSIONAL OVERSIGHT PANEL, MARCH OVERSIGHT REPORT, *The Final Report of the Congressional Oversight Panel* (Mar. 16, 2011) [hereinafter COP]; THE FINANCIAL CRISIS INQUIRY COMMISSION, *THE FINANCIAL CRISIS INQUIRY REPORT*, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Jan. 2011) [hereinafter FCIC]; OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM (SIGTARP), *FACTORS AFFECTING EFFORTS TO LIMIT PAYMENTS TO AIG COUNTERPARTIES* (SIGTARP-10-003, Nov. 17, 2009); SHEILA BAIR, *BULL BY THE HORNS* (2012); NEIL BAROFSKY, *BAILOUT* (2012); BETHANY MCCLEAN & JOE NOCERA, *ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS* (2010); GRETCHEN MORGENSON & JOSHUA ROSNER, *RECKLESS ENDANGERMENT:*

HOW OUTSIZED AMBITION, GREED, AND CORRUPTION LED TO ECONOMIC ARMAGEDDON (2011); TIMOTHY NOAH, THE GREAT DIVERGENCE (2012); Peter Eavis, *Questions Are Asked of Rot in Banking Culture*, N.Y. TIMES, Mar. 13, 2014, at B1; Carlos Garriga, *The Recent Boom in House Prices: Why Is This Time Different?*, 2013 ECONOMIC SYNOPSIS No. 32 (Nov. 22, 2013), <http://www.research.stlouisfed.org/publications/es/article/9981>; Catherine Rampell, *It's the Economy/Boom, Bust, Flip*, N.Y. TIMES SUNDAY MAG., Oct. 6, 2013, at 14; Juan M. Sanchez, *The Deleveraging of U.S. Households Since the Financial Crisis*, 2014 ECONOMIC SYNOPSIS No. 5 (Feb. 24, 2014).

2. Again, this list is a representative sample; where there are hyperlinks given below, each and all of them were last visited on Jan. 5, 2015: E.g., Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L.J. 213 (Winter 2013); W. Scott Frame, Larry D. Wall & Lawrence J. White, *The Devil's in the Tail: Residential Mortgage Finance and the U.S. Treasury* (Federal Reserve Bank of Atlanta Working Paper 2012-12, August 2012); Karen Freifeld & Ashutosh Pandey, *UPDATE 4-Assurant Settles with New York over "force-placed" Insurance*, REUTERS.COM (Mar. 21, 2013), <http://www.reuters.com/article/2013/03/21/insurance-newyork-assurant-idUSL3N0CD83P20130321>; Kenneth R. Harney, *Federal Regulators Probing Real Estate Kickback Schemes*, L.A. TIMES ONLINE (May 31, 2013), <http://articles.latimes.com/2013/may/31/business/la-fi-harney-20130602>; J. Robert Hunter, Testimony Before the National Association of Insurance Commissioners, August 9, 2012; Nate Raymond, *BofA Denies Government Claim of "Massive Fraud" in Trial Over Mortgages*, INSURANCE J. (Sept. 25, 2013), <http://www.insurancejournal.com/news/national/2013/09/25/306249.htm>; Gretchen Morgenson, *Hazard Insurance with Its Own Perils*, N.Y. TIMES (Jan. 21, 2012), [http://www.nytimes.com/2012/01/22/business/hazard-insurance-with-its-own-perils-fair-game.html?\\_r=0](http://www.nytimes.com/2012/01/22/business/hazard-insurance-with-its-own-perils-fair-game.html?_r=0); Shayndi Raice & Nick Timiraos, *Banks Blundered on Mortgage Pact/Monitor Notes Failure to Meet a Number of Standards; "This is Unacceptable," HUD Chief Says*, WALL ST. J., June 20, 2013, at C1; Shayndi Raice, *Wells Fargo Cutting 2,300 Mortgage Jobs*, WALL ST. J., Aug. 22, 2013, at C3; Louise Story, *Big Banks Face Inquiry Over Home Insurance*, N.Y. TIMES (Jan. 10, 2012), <http://www.nytimes.com/2012/01/11/business/big-banks-facing-inquiry-over-possible-insurance-fraud.html>; Paul Sullivan, *When the Lender Buys Your Home Insurance, a Call Is in Order*, N.Y. TIMES (Aug. 17, 2012), <http://www.nytimes.com/2012/08/18/your-money/home-insurance/homeowner-vigilance-needed-on-force-placed-insurance-wealth-matters.html?pagewanted=all>; Paul Sullivan, *Coping with*

*High-Priced Insurance That Lenders Make You Buy*, N.Y. TIMES (Jan. 20, 2012), [http://www.nytimes.com/2012/01/21/your-money/home-insurance/how-to-handle-force-placed-insurance-wealth-matters.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2012/01/21/your-money/home-insurance/how-to-handle-force-placed-insurance-wealth-matters.html?pagewanted=all&_r=0); Paul Sullivan, *Insurance Dictated by the Bank*, N.Y. TIMES (Mar. 25, 2011), <http://www.nytimes.com/2011/03/26/your-money/home-insurance/26wealth.html?pagewanted=all>; Mary Williams Walsh, *New York Investigates Insurer Payments to Banks*, N.Y. TIMES (May 21, 2012), <http://www.nytimes.com/2012/05/22/business/new-york-investigates-home-insurer-payments-to-banks.html?pagewanted=all>.

One of the more concise, insightful explanations is an October 30, 2013, comment by the Hon. Sheila Bair on a Securities and Exchange Commission, Federal Housing Finance Agency, and Housing and Urban Development proposed rule on credit risk retention that the agencies proposed “to implement the Dodd-Frank financial reform law’s requirement for risk retention for securitizations”:

As we saw in the years leading up to the subprime crisis, securitization’s severance of the decision to originate and fund a mortgage from the risk of the borrower defaulting, resulted in a volume driven business, as originators and securitizers were paid up front, with little, if any “skin in the game” should the loans default later on. Millions of loans were originated and securitized with scant regard to whether the borrower could or would actually repay the loan over the longer term. Mortgages with steep payment resets, abusive prepayment penalties, poor income documentation and little, if any money down, became all too common in Wall Street securitizations. Many innocent families were victimized by these shoddy practices and ended up losing their homes. However, many sophisticated home buyers also exploited the system with speculative purchases paid for with loosely underwritten mortgages and small down payments (if any).

Comments of Hon. Sheila Bair, Senior Advisor Pew Charitable Trusts, Former Chairman of the FDIC, to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, Oct. 30, 2013.

3. Except perhaps to note that the effects are still being felt in many places and professions across the country. See, e.g., Gretchen Morgenson, *Fair Game/Big Banks Still a Risk*, N.Y. TIMES, Aug. 2, 2014, at B1; Floyd Norris, *High & Low Finance/ Mortgages Without Risk, at Least for the Banks*, N.Y. TIMES, Nov. 29, 2013, at B1. According to the government organization responsible for announcing these things, the Great Recession began in December 2007, and “ended in June 2009.” National

Bureau of Economic Research report, Sept. 20, 2010, *cited in* COP, *supra* note 1, at p. 18 n. 21. Many people would dispute whether or when the Great Recession ended.

4. See Chapter 3, Section 3.1.

5. FCIC, *supra* note 1, at 105.

6. FCIC, *supra* note 1, at 6, 89.

7. FCIC, *supra* note 1, at 7. Overall, “[h]ouseholds have lost \$11 trillion in wealth since 2006.” *Id.* at 23.

8. See Fannie Mae/Freddie Mac Form 3033 1/01 NEW YORK—Single Family, 7–9, ¶ 5 and 17–18, ¶ 22; Fannie Mae/Freddie Mac Form 3010 1/01 FLORIDA—Single Family, 6–7, ¶ 5 and 15, ¶ 22. See in addition Chapter 2, Section 2.3.

9. March 2013 (undated) Consent Order between New York State Department of Financial Services, Financial Fraud & Consumer Protection Division, and American Security Insurance Company, American Bankers Insurance Company of Florida, and Assurant, Inc., in *In re* American Security Insurance Company, et al., ¶ 2 at p. 2 of “FINDINGS.” A copy of the consent order between New York State and ASIC et al. was posted online through <http://www.dfs.ny.gov/consumer/forced-placed.html>.

10. See Chapter 2, Section 2.1. “Collateral protection insurance” is used here in the generic sense of that term. Some states may exempt insurance on a home or real property from statutory definitions of collateral insurance that are intended to apply throughout an entire insurance code, as in Florida for example. See FLA. STAT. § 624.6085 (2014).

11. Kickbacks, commissions, and reinsurance payments are discussed as alleged in reported case law and as evidenced in such testimony and documentary evidence as is currently open to public view on PACER, the electronic court files of the federal court system, in particular in sections 3.2–3.6.

In addition, the New York State Department of Financial Services investigated payments by and to lenders and force-placed insurance providers in 2013. The department discovered a fact in common in some of the various investigations into different entities: in the event that lenders did not set up commission-taking subsidiaries such as captive insurance agencies, some insurance providers paid sums to mortgage servicers directly for “expenses” incurred by the servicers in connection with force-placed insurance. The department concluded that these payments “appear to be substitutes for commissions.” See, e.g., April 2013 (undated) Consent Order between the New York State Department of Financial Services, Financial Frauds & Consumer Protection Division, and QBE Financial Institution Risk Services, Inc.,

QBE Insurance Corporation, and QBE Holdings, Inc., ¶ 19 at 8; and March 2013 (undated) Consent Order between the New York State Department of Financial Services, Financial Frauds & Consumer Protection Division, and American Security Insurance Co., American Bankers Insurance Co. of Florida, and Assurant, Inc., ¶ 16 at 7. The Department of Financial Services posted these unsigned consent orders with ASIC and QBE on its website, <http://www.dfs.ny.gov>.

ASIC and QBE, it is worth noting, are “[t]he two dominant companies that perform these services and write force-placed policies in New York as well as nationwide are ASIC . . . and QBE, which together comprise at least 90% of the force-placed insurance market.” March 2013 (undated) Consent Order between the New York State Department of Financial Services, Financial Frauds & Consumer Protection Division, and American Security Insurance Co., American Bankers Insurance Co. of Florida, and Assurant, Inc., ¶ 6 at 3 (emphasis added).

12. Such is the description of reverse competition used by New York State Superintendent of Financial Services Benjamin Lawskey in his letter on April 5, 2013, to State Insurance Commissioners regarding reforming force-placed insurance at 1:

Force-placed insurers have competed for business from banks and mortgage servicers through “reverse competition”: i.e., rather than competing for business by offering lower prices, insurers have created incentives for banks and mortgage servicers to buy force-placed insurance with high premiums by enabling banks and mortgage services, through complex arrangements, to share in the profits associated with the higher prices.

The consent orders referenced in a preceding footnote put reverse competition in these terms, which are identical in both consent orders:

Commissions paid to affiliates of servicers is a form of reverse competition; when insurers compete for servicers’ business by offering higher commissions to servicers’ affiliates, there is no incentive to reduce force-placed insurance premium rates. Commissions are paid to affiliates of servicers because they are a cost of staying in the market, not for any particular work the affiliates perform.

April 2013 (undated) Consent Order between the New York State Department of Financial Services, Financial Frauds & Consumer Protection Division, and QBE Financial Institution Risk Services, Inc., QBE Insurance Corporation, and QBE Holdings, Inc., ¶ 17 at p. 8; and March 2013 (undated) Consent Order between the New York State Department of Financial Services, Financial Frauds & Consumer

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Protection Division, and American Security Insurance Co., American Bankers Insurance Co. of Florida, and Assurant, Inc., ¶ 12 at p. 6. The New York Department also made clear in both consent orders that it was applying this term to payments made directly to mortgage servicers by the two insurance companies, ASIC and QBE. *See* QBE Consent Order, ¶ 19 at p. 8; ASIC Consent Order, ¶ 17 at p. 7.

13. THE FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, at 90 (Jan. 2011).

14. See Chapter 2, Section 2.3.