THE REVIEW OF
BANKING & FINANCIAL SERVICES
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 32 No. 3 March 2016

REGULATORY AND LITIGATION TRENDS REGARDING LENDER-PLACED INSURANCE

In recent years, LPI has been the subject of significant New York state regulatory action resulting in consent decrees prohibiting certain practices that were alleged to raise insurance rates. Similar federal action on behalf of GSEs may be forthcoming in 2016. In private litigation, LPI defendants scored a notable success recently, when the Second Circuit held that the filed-rate doctrine made LPI "kickback" claims immune from challenge in the courts. The authors review these developments.

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Legal scrutiny of the lender-placed insurance ("LPI") industry and its practices began in the wake of the mortgage crisis, and has continued to simmer ever since. It began with the filing of a host of lawsuits by the plaintiffs' bar across the country against the major mortgage servicers and LPI providers, most, but not all, of which have reached settlements, and continued with certain regulators initiating investigations on an industry-wide basis, yielding substantial new regulations designed to change how LPI operates. This article surveys these regulatory and litigation trends and developments emerging over the last several years, which will define the LPI legal landscape for months and years to come.

LPI is insurance coverage obtained by mortgage lenders or servicers to protect mortgaged properties when borrowers fail to maintain adequate homeowner's insurance, as required by most standard mortgage agreements. LPI is indispensable to the mortgage industry and its overall stability. Among other things, it provides lenders with continuous protection of the collateral securing their investments, provides uninsured borrowers that suffer property catastrophes with protection against homelessness and personal liability for their outstanding loan balances, and helps facilitate a secondary market for mortgage loans, thereby lowering interest rates and widening lending resources for all borrowers.

Despite these benefits, LPI practices have not gone unchallenged, especially as borrowers faced increased financial pressures from the mortgage crisis. Regulators and litigants alike principally alleged that mortgage servicers colluded with LPI providers to charge excessive LPI premiums to borrowers. The excessiveness, they alleged, was derived from (i) so-called "kickback" payments from LPI providers to servicers or their affiliates in exchange for the right to provide exclusive LPI services, the cost of which allegedly was incorporated into the LPI premiums charged to borrowers; (ii) so-called "back-dated" LPI

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RSCR Publications LLC Published 12 times a year by RSCR Publications LLC. Executive and Editorial Offices, 2628 Broadway, Suite 29A, New York, NY 10025-5055. Subscription rates: $650 per year in U.S., Canada, and Mexico; $695 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call (937) 387-0473 or visit our website at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-876-1715; e-mail mofinkelstein@gmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail shimmelfarb@comcast.net. To submit a manuscript for publication contact Ms. Himmelfarb. ISSN: 1051-1741.

coverage to charge borrowers for retroactive periods of time; (iii) excessive LPI coverage amounts; or (iv) LPI placements for periods when other insurance was already in place.

Beginning in 2011, state and federal regulators latched onto these allegations, prompting investigations of lenders, servicers, and LPI providers, which, in turn, led to consent orders between certain state regulators and these entities, and new regulations governing an array of LPI practices. Maintaining their close watch on LPI practices, regulators recently have focused on new issues involving LPI, such as servicers' attempts to sell affiliated insurance agencies.

On the litigation side, plaintiffs have relied on similar allegations to assert a variety of state common law claims and federal statutory causes of action.[1] The September 2014 issue of this publication thoroughly detailed these issues and many other LPI litigation trends, including the success of defendants in defeating nationwide class certification, the challenges faced by objectors to class settlements, and settlements in the largest LPI class actions involving the nation's largest lenders, servicers, and LPI providers.[2] Since then, the major development has occurred at the appellate level, where, with a successful interlocutory appeal in the Second Circuit, LPI defendants, represented by BuckleySandler LLP, successfully argued the filed-rate doctrine defense, potentially shifting the balance between plaintiffs and defendants in a way many thought impossible just a few months ago. As well, over the last year, new trends have emerged, as the plaintiffs' bar searches for new avenues of attack against LPI players, including filing individual lawsuits on behalf of class opt-out plaintiffs, and filing new class actions against smaller lenders and servicers who were not parties to the initial wave of LPI class actions that have now settled.

RECENT REGULATORY TRENDS

State Regulators

The most aggressive regulatory action in recent years regarding LPI has come at the state level. Following the mortgage crisis, in 2011, the New York Department of Financial Services ("DFS") became the leader in regulatory oversight concerning LPI (where it remains today), launching the first large-scale investigation into LPI practices. This investigation led to subpoenas and public hearings, and culminated in 2013 with consent orders between DFS and the nation's largest LPI providers, the terms of which did not include any admission of liability but included several prohibitions on certain LPI practices and civil monetary penalties in the millions.[3]

DFS's chief concern was that LPI premiums were allegedly unreasonably high compared to voluntary homeowners' insurance premiums, and that these high premiums may have contributed to borrowers defaulting on their mortgage payments. DFS also was concerned that LPI providers' loss ratios (*i.e.*, the total losses paid by an insurance company in claims, plus other expenses, divided by the premiums earned) were lower than that of voluntary homeowners' insurance carriers, and lower than the ratios anticipated in the LPI providers' regulatory rate filings. The resulting consent orders based on these allegations, in which the LPI providers neither admit nor deny liability, sanctioned the LPI providers and required them to refile their LPI rates to reflect more current loss experiences. Regulators in other states, including California and Florida, took similar views, asking LPI providers in their jurisdictions to review their rates and refile them if outdated.

DFS also expressed concern with the commission structure among certain LPI providers and mortgage servicers, which it alleged was one reason for high LPI premiums. Specifically, DFS believed that because

[1] The state common law claims include fraud, breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment, tortious interference, and unfair competition. The federal claims fall under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), Truth in Lending Act, and Real Estate Settlement Procedures Act ("RESPA").

[2] Frank G. Burt, W. Glenn Merten, Richard D. Euliss, & Abigail J. Kortz, *Class Litigation of Lender-Placed Hazard Insurance*, 30 THE REV. OF BANKING & FIN. SERVICES 117 (Sept. 2014).

[3] *See, e.g.*, Consent Order, *In the Matter of QBE Fin. Institution Risk Servs, Inc., et al.* (Mar. 21, 2013), *available at* www.dfs.ny.gov/about/ea/ea_201304181_qbe.pdf; Consent Order, *In the Matter of Am. Sec. Ins. Co., et al.* (Apr. 18, 2013), *available at* www.dfs.ny.gov/about/press2013/assur-order-130321.pdf).

portions of LPI premiums may revert back to mortgage servicers through commissions paid by LPI providers to the servicer's affiliated insurance brokers, servicers are disincentivized from negotiating lower rates with LPI providers (because higher premiums allegedly net higher commissions to servicers' affiliates). In response, LPI providers and mortgage servicers argued that these commissions were justified because servicer-affiliated insurance agencies performed useful services, such as typical commercial brokerage services, legal compliance services, and services coordinating LPI notices, cancellations, and refunds. DFS maintained that these services were just a vehicle for insurers to "kickback" money to servicers as compensation for engaging with the insurer and, as a result of DFS's position, the terms of the consent orders prohibited commission payments from LPI providers to servicers or their affiliates in New York.

DFS and other regulators also have inquired into captive reinsurance arrangements between servicers and LPI providers. In this scenario, the servicer (or its insurance affiliate) would contract with the LPI provider to provide LPI services for its mortgage portfolio. The LPI carrier, in turn, would reinsure its insurance risk with a servicer-affiliated reinsurance provider. DFS alleged that these arrangements did not transfer actual risk, but instead were another method for sharing profits, which it claimed further disincentivized servicers from negotiating lower rates with LPI providers. The DFS consent orders prohibited such agreements going forward.

DFS also investigated loan tracking fee amounts charged by LPI providers to the servicers, alleging that servicers have paid below-cost or subsidized fees for loan monitoring services provided by LPI agents to track whether the properties in a servicer's portfolio are adequately insured. DFS maintained that such purportedly below-cost administrative fees were yet another means of providing compensation to the mortgage servicer and, as a result of these concerns, the DFS consent orders banned LPI providers from charging servicers for certain tracking fees that are below cost or otherwise subsidized. Those include tracking fees related to expenses that LPI providers incur when, for their own benefit, they perform tracking services to prevent themselves from (i) exposure to lost premiums or other losses on properties that have no other insurance coverage or (ii) administrative costs associated with placing and later canceling LPI on properties that never required LPI.[4]

More recently, DFS scrutinized mortgage servicers' attempts to sell their affiliated insurance agencies.[5] DFS alleged that in trying to sell affiliated agencies, which once received the now-prohibited commissions, servicers were trying to collect commissions upfront by embedding them in the sale price. While not part of the 2013 consent decrees, DFS's scrutiny into this area likely will impact corporate transactions for mortgage servicers seeking to sell off their insurance affiliates.

DFS's investigations led to a number of recently enacted restrictions and regulations governing LPI providers operating in New York. These regulations prohibit various practices, as discussed above, including compensation arrangements between LPI providers and servicers, sharing LPI premiums with servicers or their affiliates (including through the ceding of reinsurance premiums to servicer-affiliates), and reduced cost or subsidized insurance tracking fees charged to servicers or their affiliates.[6] Mortgage servicers and LPI providers should expect similar regulations to follow in other states in the wake of New York's recent regulations.

Federal Regulators

The Federal Housing Finance Agency ("FHFA") focused on LPI for the first time in March 2013. Its first order of business was directing the government-sponsored entities ("GSEs") over which it has conservatorship authority, including Fannie Mae and Freddie Mac, to prohibit mortgage servicers from receiving LPI-related commissions and other profit-

[4] Related regulations later adopted carve out from the definition of "insurance tracking," and thus from the prohibited tracking fees, (i) activities related to "issuing [LPI] or monitoring the continuing need for [LPI] after" voluntary insurance has lapsed or been canceled, or when the LPI provider has not received evidence of existing insurance or (ii) activities related to the performance of "administrative services associated with cancelling [LPI] on properties on which [LPI] is not required." N.Y. Comp. Codes R. & Regs. tit. 11, § 227.1(E)(2).

[5] *See* Aug. 4, 2014 Letter from N.Y. D.F.S. to Ocwen Financial Corporation, *available at* http://www.dfs.ny.gov/about/letters/ltr140804_ocwen.pdf.

[6] N.Y. Comp. Codes R. & Regs. tit. 11, § 227 *et seq.* (Regulation NO. 202).

sharing practices.[7] Specifically, these regulations, which became effective in June 2014, prohibit servicers from receiving, directly or indirectly, any commissions or other payments (i) in conjunction with placing LPI coverage or maintaining placement with certain LPI providers and (ii) associated with an LPI provider ceding premiums to a reinsurer that is affiliated with the mortgage servicer.[8]

Also in June 2014, the FHFA's Office of the Inspector General concluded that GSEs had "suffered considerable financial harm in the LPI market" due to "excessively priced LPI coverage,"[9] and recommended that FHFA assess the merits of possible "litigation by the [GSEs] against their servicers and LPI providers."[10] Even more ominous, FHFA accepted this recommendation and stated it would begin to act in the near future.[11] And FHFA's scrutiny is not poised to end there, as it listed LPI practices among its top priorities in mid-2014 and ordered its GSEs to "evaluate and suggest further improvements in this area."[12] Consequently, the industry may expect not only further LPI litigation — this time involving GSEs as plaintiffs — but also new efforts from FHFA to reform LPI practices in 2016.

The Consumer Financial Protection Bureau ("CFPB") also holds an interest in LPI practices. In 2010, the Dodd-Frank Act amended RESPA, 12 U.S.C. section 2601, to grant the CFPB federal regulatory oversight of the way lenders obtain LPI. These provisions include a requirement that servicers have a "reasonable basis" to believe a borrower's homeowners insurance has lapsed before purchasing LPI.[13] To establish such a basis, a servicer must follow the regulation's requirements concerning notices issued to borrowers before LPI is obtained, including the timing of such notices, the inclusion of specific information in such notices, and the precise format and style of each notice.[14] Additionally, the CFPB proposed amendments in 2014 to the mortgage servicing rules it issued in 2013, this time amending the LPI disclosure requirements imposed on servicers. These changes, and the frequency with which the CFPB has made them, highlight the role the CFPB intends to play in the LPI industry going forward, as it navigates through relatively new regulatory authority and challenges in issuing new regulations.

Notably, Dodd-Frank also provides some protection to LPI providers, including for certain LPI charges. In particular, the Act provides that any charge imposed on a borrower must be for a service that was actually performed and must bear a reasonable relationship to the servicer's cost of providing that service.[15] Excluded from this requirement, however, are "charges subject to State regulation as the business of insurance."[16] Thus, under Dodd-Frank, LPI charges calculated from insurance rates filed and approved with state insurance regulators are presumed reasonable and bona fide.

RECENT LITIGATION TRENDS

While the September 2014 issue of this publication aptly surveyed the principal issues concerning class action trends in LPI litigation,[17] several developments have since occurred involving the filed-rate doctrine defense and the continuance of LPI class actions against smaller mortgage servicers.

Appellate Approval of the Filed-Rate Doctrine Defense

The Second Circuit Court of Appeals' decision in *Rothstein v. Balboa Insurance Company*[18] — which held that LPI "kickback" claims are barred by the filed-rate doctrine — arguably is the most consequential court decision affecting the LPI industry in recent years. The filed-rate doctrine holds that any rate filed with and approved by a governing regulatory agency, as is often the case with LPI rates, is per se reasonable and thus immune from challenge by civil litigants.[19] The doctrine's rationale is two-fold, first prohibiting courts

[7] FHFA OFFICE OF INSPECTOR GENERAL, EVL-2014-009, FHFA'S OVERSIGHT OF THE ENTERPRISES' LENDER-PLACED INSURANCE COSTS (June 25, 2014), *available at* http://fhfaoig.gov/Content/Files/EVL-2014-009.pdf, 14.

[8] *Id.*

[9] *Id.* at 3.

[10] *Id.*at 3, 15-18.

[11] *Id.*at 3, 18.

[12] 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac, FHFA, May 13, 2014, at 10, *available at* http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf.

[13] 12 C.F.R. § 1024.37(b).

[14] 12 C.F.R. §§ 1024.37(c)-(f).

[15] 12 C.F.R. § 1024.37(h); 12 U.S.C. § 2605(m).

[16] 12 C.F.R. § 1024.37(h); 12 U.S.C. § 2605(m).

[17] *See supra* note 2.

[18] 794 F.3d 256 (2d Cir. 2015).

[19] *E.g., Wegoland Ltd. v. NYNEX Corp.*, 27 F.3d 17, 18 (2d Cir. 1994).

from second-guessing a regulator's authority to determine the reasonableness of rates;[20] and second, preventing discrimination against non-party consumers by ensuring that regulated entities charge only the filed and approved rate.[21]

Historically, district courts have split on the doctrine's applicability to LPI claims.[22] Thus, as the first U.S. Court of Appeals to directly address this issue and rule that such claims are barred by the filed-rate doctrine, *Rothstein* represents a sea change, providing much-needed clarity to an area previously riddled with inconsistency.

In *Rothstein*, the plaintiffs alleged that their LPI premiums were excessive because the "rates they were charged did not reflect secret 'rebates' and 'kickbacks'" that their mortgage servicer received from their LPI providers.[23] Based on these allegations, the plaintiffs asserted causes of action under RICO and RESPA.[24] The LPI providers moved to dismiss under the filed-rate doctrine, "arguing that Plaintiffs could not sue to challenge LPI rates approved by regulators."[25] The district court denied the motion in pertinent part, stating that although the filed rates were approved, "that approval did not necessarily extend to the borrowers' reimbursement to" their mortgage servicer.[26] Based on a conflict of authority among the district courts on this issue, the court certified its decision for interlocutory appeal to the Second Circuit, which reversed the district court.[27]

Rothstein is noteworthy not just for its ultimate holding that LPI "kickback" claims, which have plagued the LPI industry for years, are immune from challenge in the courts, but also the court's sound reasoning directly addressing (and rejecting) plaintiffs' usual arguments around the doctrine's safe harbor for claims challenging filed and approved insurance rates, many of which have confounded district courts for years. One argument plaintiffs almost always used to try to avoid application of the filed-rate doctrine is that they were not challenging the rates themselves, but rather the allegedly unlawful payment of "kickbacks," which plaintiffs claimed inflated LPI premiums and were not approved by state regulators. *Rothstein* did away with this distinction and conclusively held that LPI claims "rest[ing] on the premise that the rates approved by regulators were too high" are barred by the filed-rate doctrine, even if those claims "can be characterized as challenging something other than the rate itself," such as a purported "kickback scheme."[28]

Plaintiffs also often argued that the filed-rate doctrine did not apply to their claims because they did not purchase LPI directly from the LPI provider, but instead an intermediary mortgage servicer. *Rothstein* disposed of this too, holding that the filed-rate doctrine is "not limited" to the "simple A-to-B transaction" plaintiffs usually allege, where "the ratepayer deals directly with the rate filer."[29] Rather, the court held that the "doctrine operates notwithstanding an intermediary that passes

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[20] *E.g.*, *Carlin v. DairyAmerica, Inc.*, 705 F.3d 856, 868 (9th Cir. 2013).

[21] *Id.* at 867.

[22] *Compare Decambaliza v. QBE Holdings, Inc.*, No. 13-286, 2013 WL 5777294, at *7 (W.D. Wis. Oct. 25, 2013) (dismissing complaint because "the alleged kickbacks in this case are part of a premium that was approved by a regulatory entity. Allowing plaintiff to challenge them would contravene the . . . purposes of the filed-rate doctrine"), *with Ellsworth v. U.S. Bank, N.A.*, 908 F. Supp. 2d 1063, 1081-83 (N.D. Cal. 2012) (finding filed-rate doctrine inapplicable to LPI claims).

[23] *Rothstein*, 794 F.3d at 259.

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.* at 262. While *Rothstein* was the first appellate court to render this holding, it was not the first to rule in this fashion on similar bases. Indeed, while many district courts rejected the filed-rate doctrine defense (before *Rothstein*), numerous district courts around the country held that the filed-rate doctrine bars claims premised on allegations that their LPI premiums, which were calculated from the filed and approved rates, were too expensive because they included so-called kickbacks. *See, e.g.*, *Miller v. Wells Fargo Bank, N.A.*, 994 F. Supp. 2d 994 F. Supp. 2d 542, 553-54 (S.D.N.Y. 2014) (applying doctrine to LPI claims based on "unreasonably high premiums" and alleged "manipulation" of LPI market); *Curtis v. Cenlar FSB*, No. 13 Civ. 3007, 2013 WL 5995582, at *3 (S.D.N.Y. Nov. 12, 2013) (dismissing LPI kickback claims under filed-rate doctrine); *Decambaliza*, 2013 WL 5777294, at *7 ("The alleged kickbacks in this case are part of a premium that was approved by a regulatory entity. Allowing plaintiff to challenge them would contravene the . . . purposes of the filed-rate doctrine."); *Singleton v. Wells Fargo Bank, N.A.*, No. 2:12CV216, 2013 WL 5423917, at *2 (N.D. Miss. Sept. 26, 2013) (The "filed-rate doctrine applies because Plaintiff's [LPI kickback] claims implicate the reasonableness of the filed rates"); *Roberts v. Wells Fargo Bank, N.A.*, No. 12-cv-200, 2013 WL 1233268, at *13 (S.D. Ga. Mar. 27, 2013) (same).

[29] *Rothstein*, 794 F.3d at 264.

along the rate" because its twin principles "have undiminished force."[30] Moreover, the court found the plaintiffs' "distinction . . . especially immaterial in the LPI context because LPI travels invariably 'A-to-B-to-C.'"[31]

While a relatively recent opinion, *Rothstein* already appears to be taking hold across the country, as district courts not just in the Second Circuit, but also the Ninth and Eleventh Circuits — jurisdictions that had never before granted a filed-rate doctrine defense in the LPI context — have adopted *Rothstein* to dismiss LPI claims at the pleading stage.[32] All signs indicate that this trend will continue in other jurisdictions as well, breathing increased life and new clarity into a doctrine once mired by confusion and dysfunction. Indeed, if followed by other federal appellate and district courts — which has already started to happen — *Rothstein* has the potential to end, at the pleading stage, the type of LPI litigation that has exploded since the mortgage crisis.

The Plaintiffs' Bar Shifts Litigation Strategy

To evade the preclusive effect of the major LPI class settlements, the plaintiffs' bar has sought new avenues of attacking LPI practices. The first trend has involved a growing number of individual borrower lawsuits, largely comprised of plaintiffs who opted out of class settlements to extract more favorable settlements than if they had remained part of the class.[33] The second trend involves class action lawsuits against smaller mortgage servicers not yet part of a class settlement.[34] While both trends involve claims identical to those asserted in the larger class actions, outcomes may differ from years ago as *Rothstein* and its progeny bestow defendants with additional defenses under the filed-rate doctrine. ■

[30] *Id.*

[31] *Id.* at 265.

[32] *Clarizia v. Ocwen Fin. Corp.*, No. 1:13-CV-2907, 2016 WL 439018, at *3 (S.D.N.Y. Feb. 2, 2016); *Lyons v. Litton Loan Servicing LP*, No. 1:13-CV-513, 2016 WL 415165, at *8-14 (S.D.N.Y. Feb. 2, 2016); *Trevathan v. Select Portfolio Servicing, Inc.*, No. 15-61175-CIV, 2015 WL 6913144, at *3 (S.D. Fla. Nov. 6, 2015); *Haddock v. Countrywide Bank, NA*, No. CV14-6452, 2015 WL 9257316, at *18-19 (C.D. Cal. Oct. 27, 2015).

[33] *E.g.*, *Haddock*, No. 2:14-cv-06542; *Derderian v. Bank of America, N.A., et al.*, No. 2:14-cv-08067-AB-SS (C.D. Cal.).

[34] *E.g.*, *Beber v. Branch Banking & Trust Co., et al.*, No. 1:15-cv-23294-KMW (S.D. Fla.); *Edwards, et al. v. Seterus, Inc., et al.*, No. 1:15-cv-23107-DPG (S.D. Fla.).