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NEWS FROM THE VAULT

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# Think you don't need Mortgageholders Coverage? Think again!

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Some lenders question why they need insurance for their mortgaged property if they're tracking the borrower's required insurance. Now, economic risks and exposures have become more and more complicated—so has protecting your financial institution from losses associated with your mortgage portfolio. With all the different types of losses that could impair your mortgages, and the myriad of exposures from originating and servicing loans, you may need a broad, flexible product that lets you customize your insurance.

Below, you will find reasons why **Mortgageholders Coverage** is an essential part of your risk management plan.

*1.* **MISTAKES HAPPEN.** The very nature of insurance is to cover accidents, errors or omissions. In the case of mortgage impairment, one of the primary coverages is to provide back-up insurance in the event the borrower doesn't hold up their end of the bargain by maintaining required insurance. Even with tracking, mistakes are bound to happen. Employees can make mistakes or miss something. Systems can have glitches. Insurers may neglect to send notice to the mortgagee, mail may be lost, misdirected, or take too long to reach you. Tracking significantly reduces the chance of unknown lapses in insurance, but the risk remains.

2. **GSE REQUIREMENTS.** If a lender is originating loans under a Government Sponsored Entity, such as Fannie, Freddie, Ginnie or FHLB, these entities require their lending partners to have coverage for Mortgage Impairment, Failing to Maintain a Guarantee, Errors or Omission in Maintaining Property Insurance or making Real Estate Tax Payments and Errors in Determining Flood Insurance.

3. **ADDED PROTECTION.** A Mortgageholders coverage product provides many essential coverages beyond Mortgage Impairment. Lenders have risks and liability associated with originating and servicing mortgage loans, such as:

> a. *Managing Escrow Accounts* – if an error or omission occurs in making payments for insurance or real estate taxes, there could be an uncovered property or liability claim, or even government confiscation of the mortgaged property for unpaid real estate taxes or assessments.
>
> b. *Effecting Title Insurance* – Lenders typically purchase title insurance for their own benefit and offer borrowers the opportunity to include coverage for their benefit as well. If the lender mistakenly doesn't affect coverage, and an issue with the title arises that would have been addressed by Title Insurance, the borrower would likely seek restitution from the lender.

*c. Maintaining Guarantees & Mortgage Insurance* – Lenders often have loan guarantees or mortgage insurance in place to protect themselves from borrower default. With that, protection comes with a lot of reporting and notification requirements to maintain the guarantee or mortgage insurance. An error or omission can void the protection, and in the event of a borrower default, the foreclosure sale may yield less than what the guarantee or mortgage insurance would have covered.

*d. Security Filings* – After loan origination, lenders file the lien security to document their interest in the mortgaged property. If an error or omission is made in filing the security, such as an address typo, the borrower may be able to sell the property outright and take another loan with a superior position leaving the lender out of luck. If mistakes aren't discovered before the borrower sells or takes another loan, the lender may suffer a loss.

*e. Broadened Property Damage* – Most borrowers don't just purchase the "required perils", often limited to named perils or Fire and Extended Coverage. Coverage would likely include Special Causes of Loss, formerly known as "All Risks" (subject to exclusions). As the mortgagee on the policy, lenders benefit from this broader protection of their mortgaged property.

*f. Coverage Beyond Typical Borrower Insurance* – Some exposures to loss may be worth insuring against even though most borrowers don't cover the perils. For example, lenders only require flood insurance on properties located in a Special Hazard Flood Area (SFHA). Even then, the maximum amount of coverages available from the National Flood Insurance Program (NFIP), is low. Lenders may want to consider excess flood coverage above the limited coverage provided for properties located in SFHAs. With roughly half of flood losses occurring in non-SFHAs, lenders may want to purchase flood coverage for properties that are not located in SFHAs or consider insuring against earthquake loss.

*g. Flood Zone Determination* – Lenders typically determine the flood zone, directly or through a third party, to see if the Flood Act requires the borrower to carry Flood Insurance. A misrepresentation of the zone could result in a borrower lacking flood insurance as required by the Flood Act and suffer an uninsured flood loss. Had the lender represented the zone correctly, required flood insurance would have been placed.

If you weren't aware or were on the fence when it comes to adding Mortgageholders Coverage for your property, hopefully the examples listed above have inspired you to consider it. In complex and complicated scenarios, it is reassuring to know you can be covered and avoid losses.

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