

INSURANCE

Avoid The Pitfalls And Find Insurance That Meets Your Requirements

On the surface, the news seems good. The insurance market is softening and rates throughout the industry, including for mortgage bankers, are decreasing. But just because rates are going down doesn't mean your guard should follow suit.

Consider that carriers looking to increase cash flow are expanding into new areas - such as mortgage banking - and offering hard-to-refuse rates. However, insurance is cyclical. So when rates increase, these same carriers might decide to exit the mortgage banking insurance market.

As long as your record is spotless, it's just a hassle. However, if you file a claim, you'll have a mark on your record, and you'll be looking for a

new carrier at a time when rates are up. Your thriftiness today could be quite costly down the road.

That's just one of the pitfalls. Here are ways to sidestep the other major traps: seek an insurance broker, choose a carrier and purchase fidelity/employee dishonesty, errors and omissions/mortgage impairment and professional liability. We'll take an especially close look at how to compare quotes, determine limits, and

***Is price your only criteria?
Look beyond the premium to protect
your firm from an expensive loss.***

By Lee Brodsky

meet warehouse lender and secondary market requirements.

There are a lot of factors that go into determining the insurance you need and the limits to set. This can include investor, warehouse lender and secondary market requirements; current trends; type of loans you originate and service; how policies are written; etc. Without an insurance broker who understands mortgage banking, you could end up underinsured or with the wrong insurance.

A specialist will also know how to work with carriers to acquire coverage for you that complies with investor or warehouse lender requirements. For instance, because the mortgage banking insurance market is a small sub-market, carriers may try to sell you standard forms, such as a finance company blanket bond. If your broker is not knowledgeable and doesn't amend the form, it won't comply with the investor's or warehouse lender's requirements.

In addition, some carriers will only do business with a broker or firm who is writing above a certain volume with them. A general insurance broker may be limited in his ability to seek quotes. A specialist, since he's focused on mortgage banking insurance, will have more options.

Picking carriers

Choose a carrier with a good track record and rating.

The best way to avoid problems caused by carriers jumping in and out of the market is to choose a carrier with a good track record. A good broker will know the carriers and their history in the mortgage banking arena. Rather than picking the new guy, choose a carrier that's established and has a history of stability in insurance for mortgage lenders. It's best to build a relationship with your carrier, so when you have to file a claim, you can work through it together.

Also, your broker will help you se-

lect a carrier with a high rating. Ratings, as determined by the A.M. Best Company, provide an assessment of an insurer's financial strength and ability to meet ongoing obligations to policyholders. Most investors also require a highly rated carrier, stipulating an A- or better rating.

Go beyond meeting investor fidelity requirements.

Many people think fidelity covers any type of dishonesty. Actually, fidelity/employee dishonesty is often specifically defined in a policy to be "improper personal financial gain by an employee with the intent of causing a loss to the employer."

If left as is, this definition can leave you open to uncovered losses. For instance, what if an employee steals money and gives it to someone

else? This case doesn't meet the definition because the employee didn't personally profit. To protect your firm, your broker should ask for a "Robin Hood" clause and several other addenda.

When setting policy limits, meeting investor requirements should not be the only determinant. For example, Fannie Mae bases its requirements solely on servicing volume. If you're a Fannie Mae seller/servicer that originates much higher volume than you service, you could be underinsured even though you're meeting the requirement.

Experience shows there's a greater risk of dishonesty in the origination process. Therefore, it's important to go beyond investor and secondary market requirements and determine your firm's specific risk management needs. An experienced broker will advise you on these issues.

Be sure to consider the type of loans in your portfolio and the risks



BRODSKY

Lee Brodsky recently established the Mortgage Banking Insurance Group at JMB Insurance. An independent brokerage without ties to specific carriers, his group helps mortgage bankers and brokers procure operational insurance that meets client goals and satisfies investor requirements. For more information, go to mortgagebankinginsurance.com, e-mail mail@mortgagebankinginsurance.com or call (312) 915-2226.

inherent in that type of business. For example, subprime loans are a greater risk than conventional loans. High LTV loans are also more risky. If your portfolio is weighted heavily in these areas, you might want to increase your limits to be sure you are not underinsured.

When looking to comply with investor requirements, note that standard fidelity bonds don't extend to your firm's partners or owners. The theory is that if you're an owner who's stealing from the corporation, there's no reason to reimburse you for the money you stole from yourself.

However, some investors require you to carry fidelity coverage to protect from "theft of investor's money or collateral by owner, principal, major shareholder or partner." When comparing coverages, make sure this investor protection is included. Keep in mind too, each warehouse lender has unique requirements. Make sure you're in compliance with all of the ones with which you do business.

Get adequate coverage

Make sure your mortgagee's errors and omissions (E&O) and mortgage impairment provide enough coverage.

If you're escrowing or checking for property insurance and taxes, you need mortgagee's E&O insurance. It covers your mortgagee interest plus your liability to mortgagors and investors in case you make errors that leave their property underinsured,

uninsured or with unpaid taxes.

If you're not checking, you need mortgage impairment to protect your mortgage interest, your owner interest in foreclosed properties and your investor interest in case there are losses to uninsured or underinsured properties in your portfolio.

When comparing policies, make sure the coverage doesn't limit its scope. Residential lenders need to have fire, flood and extended coverage perils, plus liability and more. Additionally, commercial lenders should extend their coverage to include business interruption, loss of rents and more. Investors, warehouse lenders and secondary markets usually require these coverages.

Once again, investor and secondary market requirements shouldn't be the only determining factor in setting your limits. Look at your business. What kinds of loans do you handle? What's your largest loan? Where are properties located? Could one event - a flood or earthquake - affect multiple properties? If you just rely on investor guidelines or requirements, your limit may be too low.

Each investor, warehouse lender and secondary market has very specific requirements. This is where a mortgage banking insurance specialist comes in handy, because he'll know what's needed. In addition, some investors require commercial lenders to base their E&O/mortgage impairment limit off the largest loan, but have a different requirement for

fidelity. Therefore, you'll need a carrier that can offer you different limits on these coverages.

Professional liability E&O and mortgagee's E&O are different. Get both.

Many people think if they have the mortgagee's E&O coverage required by investors, they already have professional liability. This is not the case. Mortgagee's E&O covers specific losses due to failure to obtain and maintain insurance, to determine that a property is in a flood



zone and to pay taxes.

Professional liability is more general. Think of it as business malpractice insurance that protects you from lawsuits arising from other services you render as a mortgage banker or broker. Common suits addressed by professional liability policies include bait and switch on loan offerings, ARM or interest miscalculation, and failure to provide proper disclosures under TILA (Truth in Lending Act) and RESPA (Real Estate Settlement Procedures Act).

Generally, professional liability is written to cover all negligent acts, errors and omissions for which you're

legally liable. Carriers then add exclusions to take away what they don't want to cover. In some cases, as in loan repurchase, they'll take the coverage away but may allow you to add it back by raising your premium.

Read the fine print, or get your broker to compare what's being excluded and the cost to get it back. Keep in mind that if the carrier wants to exclude a risk, it is likely that a loss in that area would put your firm's financial stability at risk.

Check to see if policies are written as "pay on behalf of" or on an indemnification basis. "Pay on behalf of" means the carrier pays the claim directly - you don't pay out of pocket. Indemnification, which is less desirable, means the carrier reimburses you after you've paid the claim.

Since suits can take years, this difference can make a sizeable dent in your cash flow. Additionally, some policies are written so the carrier actually takes on your defense in a lawsuit, meaning that beyond the deductible you don't incur the losses inherent during a long legal battle.

Investors and secondary markets usually don't require professional liability insurance. Some warehouse lenders are starting to require a minimal amount - around \$150,000 to \$300,000.

As in every other case, look beyond the requirements and beyond the premiums to determine the amount of coverage you should carry to protect your firm from an expensive loss.