Mortgage Impairment / Mortgagee's Errors & Omissions Insurance – Frequently Asked Questions

What is Mortgage Impairment / Mortgagee's Errors & Omissions insurance?

Mortgage Impairment provides insurance coverage to a financial institution for a loss to its "mortgage interest" (defined as interest in real property as security for a loan) caused by the lack, or inadequacy, of insurance for Required Perils. Required Perils are the perils against which the mortgage agreement requires the borrower to insure the collateral property. These perils are fire, flood, and other similar direct physical damage perils. These Required Perils are typically covered by homeowner's insurance, fire and extended coverage insurance, and flood insurance policies.

Mortgagee's Errors & Omissions provides liability insurance to a financial institution for negligent acts, errors, or omissions in procuring and/or failing to maintain insurance for Required Perils (as detailed above).

What does this coverage do for me as a mortgage lender or mortgage servicer?

Mortgage Impairment insurance covers loss to the insured's "mortgage interest" resulting from physical damage to mortgaged property and: • Lack, or inadequacy, of insurance for Required Perils • Lack, or inadequacy, of insurance for Non-Required Perils (such as earthquake and flood insurance • Tax seizure • Defective title	Mortgagee's Errors & Omissions insurance covers the insured's liability in: • Failing to obtain or maintain required property insurance, including flood insurance • Flood zone determination • Failing to secure FHA/VA/PMI guarantees • Failing to obtain or maintain life or disability insurance on the borrower (mortgagor) • Failing to pay real estate taxes or special assessments

What are some examples of claims that have been covered by this insurance?

<u>*Mortgage Impairment*</u>

A medium sized financial institution suffered a loss as a result of fire damage to a large residential property. The financial institution had an outstanding mortgage balance on the property. The borrower had put the house on the market earlier in the year, and there were no interested buyers. According to the fire investigation by the homeowner's insurer, and the findings of the local fire marshal, the borrower committed arson. The apparent motive was to obtain the insurance proceeds from the underlying homeowners' policy in order to satisfy the outstanding mortgage obligation on the property.

In this claim, the financial institution was mistakenly not listed as Mortgagee in the homeowner's policy and the claim was denied by the homeowner's insurer. Thus, the following criteria were met for a covered claim under the **Mortgage Impairment** section of the **MIP** policy:

- Physical damage to the property as the result of a Required Peril
- No direct (homeowner's) insurance was in place, or the insurance in place was inadequate / uncollectible
- There was a direct loss to the Insured's "mortgage interest", as they lost the collateral for their loan to the borrower

Mortgagee's Errors & Omissions

A financial institution failed to procure Private Mortgage Insurance ("PMI") on several dozen loans. PMI is an insurance policy issued to a lender, and paid for by the borrower, to protect the lender against loss on a defaulted mortgage loan.

The financial institution had a system in place whereby PMI was required to be procured when a borrower made a down payment on a house that was less than 20% of the total property value. Due to the actions of one employee, the insured had collected the money from the borrowers to purchase the PMI policies, but never actually procured the policies from a private mortgage insurer. Due to a decline in property values, half of these loans had since gone into default. Each of the defaulted loans without proper PMI had been sold to a secondary market investor. The amount recovered on each property through foreclosure and sale was insufficient to cover the outstanding mortgage loan balance. The investor turned to the financial institution for recovery of the loss sustained as a result of its failure to procure PMI. The claim was covered under the **Mortgagee's Errors & Omissions** section for the negligent acts, errors or omissions in failing to procure qualified private mortgage guarantee insurance.

Why else do I need this coverage?

Even in a period of relatively benign foreclosure levels, MIP insurance provides essential coverage for the entire loan servicing portfolio of a mortgage lender / servicer, including: residential loans, commercial loans, mobile home loans, construction loans, second mortgage loans, and home equity loans. However, the mortgage and real estate markets are cyclical. When real estate foreclosures and loan delinquencies increase, this insurance policy becomes even more critical, as the exposure for uninsured property loss dramatically increases for most lenders / servicers. That fact, coupled with increasing demands on lenders and servicers for refinances, loan modifications, etc., and the resulting increased likelihood of an error or omission, makes **Mortgage Impairment / Mortgagee's Errors & Omissions** insurance more valuable than ever.

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