Lenders Gone Wild

Dealing with Insurance Issues Involving Banks, Mortgagees, and Other Lenders



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Florida Association of Insurance Agents
Independents Insurance Agents & Brokers of America

HANDOUT

"Lenders Gone Wild"

Dealing with insurance issues involving banks, mortgagees, and other lenders

Course Description

When customers buy real estate or procure loans for business activities or property acquisitions, lenders often have many insurance-related requirements. Many of them are necessary and proper. However, many are not and are based on antiquated requirements, onerous demands, or are possibly in violation of state laws. This webinar focuses on issues that agents should be aware of in order to best serve the needs of their customers while minimizing E&O exposures.

Learning Objectives

At the conclusion of this seminar, you should be able to:

- Distinguish between proper and improper lender requests.
- Understand the difference between lender preferences and requirements of entities like Fannie Mae and the NFIP.
- Respond to unreasonable lender requests involving property valuation and other insurance issues.
- Understand what types of "certificate" requests can be honored.
- Ensure that the agency follows proper legal requirements and E&O procedures.

Presenters

- Moderator: Bill Wilson, CPCU, ARM, Independent Insurance Agents & Brokers of America
- Lead Presenter: David Thompson, CPCU, AAI, Florida Association of Insurance Agents
- "In the Trenches" Presenters: 2+ surprise guests

Subject Matter Outline

- Introduction
 - o Opening remarks
 - o Setting the stage example 1
 - o Setting the stage example 2
 - o Your "One Stop Shop"
 - o The basis for many lender issues
- Fannie Mae Guidelines
 - o Fannie Mae "Selling Guide"
 - o http://www.allregs.com/tpl/Main.aspx
 - o Financial ratings of carriers
 - o Coverage requirements
 - VU article: "Don't Insure for the Mortgage Amount (Regardless of What the Bank Says)" http://www.independentagent.com/Education/VU/Insurance/Personal-Lines/Homeowners/Conditions/WilsonMortgageAmount.aspx
- Deductibles
- Condo Projects
 - o Project approval
 - o Condo project insurance policy review
- GRC Wording
 - o Fannie Mae does NOT require "GRC" or agreed value
 - o Lender examples
- Agreed Value
 - o Myths
 - o Example #1
 - o Example #2
- Other Replacement Cost Issues

- o 100% RC Wording
- o Failure to replace
- o COIs
- o Inflation guard
- Other condo coverages
- Ordinance or Law Coverage
 - When required/needed
 - o Commercial property
 - o Homeowners
 - o Non-ISO forms
- NFIP Requirements
 - o Fannie Mae
 - o Detached structures
 - Acceptable flood insurance
 - o Lender letter
 - NFIP amount of coverage condo associations
 - o Condo associations how many policies?
- Liability and Other Insurance Issues
 - o Condos, co-ops, etc.
 - CGL severability issues
 - o Fidelity coverage
 - VU "AAE" example
 - VU articles..."Condos and Additional Insureds"
 http://www.independentagent.com/Education/VU/Insurance/Personal-Lines/Homeowners/Condo-Issues/FacultyCondoAls.aspx
 - VU issue...business income additional insured endorsement for lenders
 - VU articles...insuring triple net lease exposures
 - http://www.independentagent.com/Education/VU/Insurance/Commercial-Lines/Property/Other/FacultyTriple02.aspx
 - http://www.independentagent.com/Education/VU/Insurance/Commercial-Lines/Property/Other/WilsonTriple.aspx
 - http://www.independentagent.com/Education/VU/Insurance/Commercial-Lines/Property/Other/FacultyTriple.aspx
 - VU article... "Insurance Requirements in Commercial Property Loan Agreements" http://www.independentagent.com/Education/VU/Insurance/Commercial-Lines/Property/Other/MahurinLoans.aspx
- The Proper Documents to Use
 - Certificate of Liability Insurance
 - o Evidence of Commercial Property Insurance
 - ACORD 28 example
 - o Evidence of Flood Insurance
 - VU "AAE" lender COI request examples
 - Banks being audited example
 - Nit picking example
 - Florida VU example
- Recorded Lines
 - o Example
 - o E&O considerations
- Replacement Cost Estimators
 - o Examples
 - o Beware E&O exposure
 - Legal issues, including statutory considerations
- Lender-Specific Forms

- o Examples
- o Email and response
- Resources
- Standing Firm
- Q&A

Agreed Value Coverage and Fannie Mae

By David Thompson, CPCU

One of the most common requests that an agency receives from a lender that relates to insurance is on a condominium master property policy regarding agreed value coverage. The request (or demand) goes like this: "Per Fannie Mae guidelines, agreed value coverage is required so please add it and provide evidence of this coverage."

The lender is, unfortunately, incorrect. The Fannie Mae Selling Guide <u>does not require agreed</u> <u>value coverage</u>, despite what the lender says. To understand this, it's important to carefully read the Fannie Mae guidelines and pay attention to specific words and punctuation. Section B7-3-04 states this:

Insurance must cover 100% of the insurable replacement cost of the project improvements, including the individual units in the project. An insurance policy that includes any of the following coverage, either in the policy language or in a specific endorsement to the policy, is acceptable:

- Guaranteed Replacement Cost—the insurer agrees to replace the insurable property regardless of the cost,
- Extended Replacement Cost—the insurer agrees to pay more than the property's insurable replacement cost, or
- Replacement Cost—the insurer agrees to pay up to 100% of the property's insurable replacement cost.

Policies with Coinsurance

Policies with coinsurance provisions can create additional risk for an HOA in the event of a loss if the amount of insurance coverage is less than the full insurable value. Master property policies that provide coverage at 100% of the insurable replacement cost of the project improvements, including the individual units, alleviate the risk of a coinsurance penalty being applied in the event of a loss.

If the policy has a coinsurance clause, inclusion of an Agreed Amount Endorsement or selection of the Agreed Value Option (which waives the requirement for coinsurance) is considered acceptable evidence that the 100% insurable replacement cost requirement has been met. If an Agreed Amount/Agreed Value provision is used, the Agreed Amount must be no less than the estimated replacement cost.

If the policy includes a coinsurance clause, but the coinsurance provision is not waived, the policy is still eligible if evidence acceptable to the lender confirms that the amount of coverage is at least equal to 100% of the insurable replacement cost of the project improvements. This evidence (documentation) must be maintained by the lender.

Note, again, that agreed value coverage is not required.

I have verified this three times with upper level management at Fannie Mae on phone calls and also received this email from Fannie Mae:

From: <<<name removed>>>

Sent: Tuesday, August 06, 2013 6:28 PM

To: David Thompson

Cc: <<<names removed>>>

Subject: RE: Insurance Contacts at Fannie Mae

David,

You are correct that the Selling Guide does not state a requirement for "agreed value" coverage. The Selling Guide does state that we accept guaranteed replacement cost coverage but we do not **require** it. The Selling Guide states our requirements for insurance policies in Section B7-3 of the Selling Guide and Part II of the Servicing Guide. Since I know you are familiar with our Guides I will not extend the length of this email by pasting a long excerpt here.

Thanks,

<<<name removed>>>

Director, Single Family Credit Risk Policy

The problem, as I see it, is that lenders, as well as Fannie Mae, don't understand what agreed value does. Check out <u>our article</u> dealing with agreed value coverage for a full explanation. The statement by Fannie Mae that agreed value "ensures full replacement cost" is incorrect. Too many people think that agreed value is like the old "guaranteed replacement cost" endorsement on a homeowners policy that no carrier uses in Florida these days. That endorsement simply stated that the Coverage A limit on a homeowners policy would be increased after the loss to a figure adequate to rebuild. After the Oakland fires of 1991 and Hurricane Andrew of 1992, that endorsement started to go away. Agreed value is totally different than the homeowners endorsement. First, agreed value is not an endorsement; it's activated by indicating such on the declarations page. Agreed value suspends the coinsurance provision of the policy if the conditions of agreed value are complied with, that being a properly completed Statement of Values (SOV) is submitted to the carrier each year and accepted by the carrier. If the SOV is not properly submitted, the coinsurance provision of the policy applies. Insurance Services Office (ISO) rules stipulate that for agreed value coverage to apply, the 90 percent coinsurance rate must be used.

For example, assume that a building has a replacement cost of \$1 million and a properly completed SOV is accepted by the carrier. After a \$400,000, loss it is determined that the true replacement cost is \$1.3 million. Since the carrier accepted the SOV and agreed value was indicated on the declarations page, no coinsurance penalty applies. Assume, however, that the

loss was \$1.1 million or even a total loss. Agreed value does not mandate that more than the \$1 million policy limit is paid. There is no standard endorsement available on the commercial property policy to increase the \$1 million coverage after the loss if the \$1 million was not adequate.

Certainly, agreed value is a valuable option when available. Thus, the problem; few carriers offer this option.

The key with lenders is to educate them that Fannie Mae does not require agreed value and also advise them that this coverage is seldom available in Florida.

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Requesting Evidence of Insurance

A Message from EVP and Director of Government Affairs Anthony DiMarco:

We have been asked by the Florida Association of Insurance Agents to pass along information on insurance problems occurring at closings. Because we are in full Legislative Session mode now, and information on the session would be outdated by the time the magazine is delivered, we thought this would be a good time to share this information with you.

The article is written by David Thompson, CPCU, AAI, API, Florida Association of Insurance Agents. We hope this helps clear up any misunderstandings on this issue.

rior to a loan closing, it is standard practice that the lender requests evidence of insurance from the customer's insurance agent. The standard documents used for this purpose include a copy of the policy declarations page, the ACORD Form 75 Insurance Binder, or the ACORD Form 27 Evidence of Property Insurance (EPI). It is important that lenders understand the proper use of these documents, what information can be placed on the forms by the insurance agent and the Florida Statutes that pertain to this issue. Several key points are worth mentioning here.

Requests for unique wording

It is not uncommon that lenders

advise the insurance agent that wording such as "100 percent replacement cost," "guaranteed replacement cost," "full replacement cost" and similar wording must appear on the EPI. Those terms are not defined in the standard homeowners policy and such coverage is also not provided in the policy. An insurance agent who adds wording to an EPI or binder that is not supported by the policy violates Florida Statute 626.9541(1)a and risks the loss of his/her insurance license, as well as substantial fines from the Department of Financial Services. It also violates the license agreement that the agent agrees to with the ACORD Corporation.

Lenders should not request such unique wording on an EPI or binder and should accept a properly completed EPI or binder from the insurance agent as valid proof of insurance. Additionally, some legal authorities take the position that a lender who demands wording not supported in the policy also violates the same statute, which states: "Knowingly making, issuing, circulating, or causing to be made, issued, or circulated, any estimate, illustration, circular, statement, sales presentation, omission, comparison, or property and casualty certificate of insurance altered after being issued, which"

Insuring for the loan amount

Insurance policies provide coverage for buildings and do not cover the land. On the other hand, loans are typically made on the entire value of the property, including the land. Insurance policies should be written to cover 100 percent of the replacement cost of the structure and the loan amount has no bearing on the amount of insurance. In many situations, the loan amount greatly exceeds the replacement cost of the structure. In fact, Florida Administrative Code Chapter 69O-167.009 states: "No mortgage lender shall, in connection with any application for a mortgage loan in this state which is secured by a mortgage on residential real estate located in this state, require any prospective mortgagor to obtain by purchase or otherwise a fire insurance policy in excess of the replacement value of the covered premises as a condition for granting such a mortgage."

Even if a policy were issued for the loan amount and in excess of the replacement cost, the maximum the policy will pay is the actual replacement cost of the structure. An insurance company that collects a premium for coverage that will not be provided violates Florida Statute 626.9541.

Requests for the agent to provide a copy of the replacement cost estimator form

Just like the appraisal ordered by the lender, the credit report obtained on the borrower, the application

Continued on page 29



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Government Relations

Continued from page 12

for loan and financial information supplied to the lender by the borrower is personal information and proprietary information of the lender; so, too, is the replacement cost estimator (RCE) form completed by the insurance agent. Lenders should examine the EPI or binder submitted by the insurance agent and, if there is disagreement over the amount of insurance, the lender should review the appraisal's replacement cost estimate and address discrepancies with the insurance agent to reach mutual agreement. III





February 20, 2013

Mr. David Thompson CPCU Florida Association of Insurance Agents PO Box 12129 Tallahassee, Florida 32317-2129

Dear Mr. Thompson:

This will confirm our conversation earlier today regarding the demands placed on insurance agents by lenders. It is our understanding lenders are making the following requests to insurance agents:

Requests for unique wording: It's not uncommon that lenders advise the insurance agent that wording such as "100 percent replacement cost," "guaranteed replacement cost," "full replacement cost," and similar wording must appear on the "Evidence of Property Insurance (EPI)". Those terms are not defined in the standard homeowners' policy and such coverage is not provided in the policy. An insurance agent who adds wording to an EPI or binder that is not supported by the policy violates Florida Statute 626.9541(1)a and risks the loss of his/her insurance license as well as substantial fines from the Department of Financial Services. Lenders should not request such wording on an EPI or binder and should accept a properly completed EPI or binder from the insurance agent as valid proof of insurance.

Coverage must match amount of loan: Insurance policies provide coverage for structures and do not cover the land. Loans are typically granted to finance the entire value of the property including the land. Insurance policies should be written to cover the replacement cost of the structure and the loan amount has no bearing on the amount of insurance. In many situations, the loan amount greatly exceeds the replacement cost of the structure. In fact, Florida Administrative Code Chapter 69O-167.009 states this: "No mortgage lender shall, in connection with any application for a mortgage loan in this state which is secured by a mortgage on residential real estate located in this state, require any prospective mortgagor to obtain by purchase or otherwise a fire insurance policy in excess of the replacement value of the covered premises as a condition for granting such a mortgage." Even if a policy were issued for the loan amount and in excess of the replacement cost, the maximum the policy will pay is the actual

replacement cost of the structure. An insurance company that collects a premium for coverage that will not be provided violates Florida Statute 626.9541.

Requesting copy of Replacement Cost Estimator: The Replacement Cost Estimate form is the work product of the agent and/or insurance company. Before providing this to an outside source, written permission of the insurance company should be obtained.

I have also enclosed for your review an Informational Memorandum issued by the Office of Insurance Regulation February 21, 2003. This memorandum was issued to all Property & Casualty Insurance Companies as a direct result of this practice by lenders.

It was a pleasure discussing this with you. If you have additional questions, please feel free to contact me.

Sincerely,

Sharron Daniel

Senior Management Analyst



INFORMATIONAL MEMORANDUM OIR-03-003M ISSUED

February 21, 2003
Office of Insurance Regulation
Kevin M. McCarty
Director

All Property and Casualty Companies

Certificates of Insurance

The purpose of this Memorandum is to address the improper practice of modifying certificates of insurance. It has been brought to the attention of the Office of Insurance Regulation that some individuals or entities may be printing or altering certificates of insurance to incorporate "hold harmless" agreements or other types of clauses in an attempt to modify the terms or conditions of the underlying insurance policy.

Certificates of insurance generally serve only as evidence of insurance in lieu of an actual copy of an insurance policy. An insurer is under no obligation to abide by any certificate of insurance which has been modified by any person or entity which does not have actual or apparent authority to do so. Distribution of a certificate of insurance which has been modified without authorization and which purports to alter the provisions of the underlying policy, misrepresents the conditions or terms of the insurance policy in violation of Section 626.9541(1)(a)1, Florida Statutes, thereby subjecting the person or entity modifying the certificate to license discipline and administrative fines.

Insurers are requested to notify their agents regarding this Memorandum.

If you have any questions regarding this Memorandum, please contact Richard Koon, Senior Management Analyst Supervisor, Bureau of Property and Casualty Forms and Rates at (850) 413-5346.

INSURING FOR THE MORTGAGE AMOUNT

When an insurance company provides coverage on a structure, they strive to write an amount of insurance that is equal to the current replacement cost. Current replacement cost is best described as what it would cost (in today's dollars) to rebuild only the structure from the slab up. That figure can be determined from a contractor's estimate, an appraisal showing the "estimated cost new," or by an insurance agency figuring the estimated replacement cost using methods which account for local costs and classes of construction. The insurance policy does not insure the land. The insurance policy is not based on any other figure, such as mortgage value, assessed value, appraised value, or market value.

Often a mortgage lender will ask that the insurance policy provide coverage equal to the mortgage amount. However, the mortgage is made based on the value of the house and land. Since the insurance policy does not cover land, the two figures have nothing to do with each other...but try convincing the lender of that.

For example, let's assume that someone purchases a lot worth \$100,000 and then builds a house that costs \$100,000 to construct. The house and land have a total "market value" of \$200,000 and the lender might loan \$160,000 on the property. Since the house has a replacement cost of \$100,000 that is all the insurance policy should provide. The lender may say, "We have to protect our interest so we want \$160,000 of insurance." Since the insurance company only insures the house itself, the company should not provide the amount of coverage the lender has requested. The lender has its interest protected because even if the house is totally destroyed they still hold a mortgage on the land, which has a value of \$100,000, plus the insurance company will pay them for the loss of the house.

When your client has trouble explaining this to the lender, tell them the Florida Administrative Code prohibits a mortgage lender from requiring insurance in an amount that exceeds the replacement cost of the home.

690-167.009 Mortgage Fire Insurance Requirements Limited

No mortgage lender shall, in connection with any application for a mortgage loan in this state which is secured by a mortgage on residential real estate located in this state, require any prospective mortgagor to obtain by purchase or otherwise a fire insurance policy in excess of the replacement value of the covered premises as a condition for granting such a mortgage.

Also, any insurance licensee who knowingly over insures a structure violates the Florida Statute below and risks loss of license and/or significant fines.

626.621 Grounds for discretionary refusal, suspension, or revocation of agent's, adjuster's, customer representative's, service representative's, or managing general agent's license or appointment.

The department may, in its discretion, deny an application for, suspend, revoke, or refuse to renew or continue the license or appointment of any applicant, agent, adjuster, customer representative, service representative, or managing general agent, and it may suspend or revoke the eligibility to hold a license or appointment of any such person, if it finds that as to the applicant, licensee, or appointee any one or more of the following applicable grounds exist under circumstances for which such denial, suspension, revocation, or refusal is not mandatory under s. 626.611:

(7) Willful overinsurance of any property or health insurance risk.

Another article dealing with this subject, including information on Florida and a host of other states, can be found on the web site of the Independent Insurance Agents and Brokers of America's <u>Virtual University</u>. In the research library under "personal Lines" and "Homeowners" is an article titled <u>"Don't Insure for the Mortgage Amount (Regardless of What the Bank Says.)"</u> To get a free account, send an email to logon@iiaba.net and in the subject line put, "Request user account."

Additionally, there may be some help available from another industry trade association. The Florida Bankers Association, in their February, 2002 *Florida Banking Magazine*, published the following article. Should an agency experience a situation where a bank requests an incorrect amount of insurance it may be appropriate to refer that bank to their trade association.

Florida Bankers Magazine, February, 2002

Should the mortgagor insure for replacement cost or the entire mortgage amount?

By Keevin Williams
FBA Vice President of Government Affairs, Insurance Division
Kwilliams@flbankers.net (850) 224-2265

Imagine: A customer of your bank purchases a lot worth \$100,000 and then decides to build a house that costs \$100,000 to construct. The house and lot have a total market value of \$200,000. As the lender, you decide to loan \$160,000 on the property. Now, an issue has arisen from the above scenario: Should you require the customer to obtain a fire insurance policy to cover the amount of the mortgage, to protect your interest, or the replacement cost of the house? A common practice may be to require the customer to obtain a fire insurance policy to cover the entire amount of the mortgage. Such a requirement may be in violation of an insurance rule. The purpose of this article is to attempt to clarify the rule and its application.

Pursuant to section 624.308(1), Florida Statute, the Florida Department of Insurance has promulgated a rule to govern the above scenario. Rule 4-167.009 of the Florida Administrative Code provides the following:

No mortgage lender shall, in connection with any application for a mortgage loan in this state which is secured by a mortgage on residential real estate located in this state, require any prospective mortgagor to obtain by purchase or otherwise a fire insurance policy in excess of the replacement value of the covered premises as a condition for granting such a mortgage.

Under a strict interpretation of this rule, which regulators tend to do, no mortgage lender, which includes financial institutions acting as a mortgage lender, may require a customer who secures a loan for residential real estate to obtain a fire insurance policy for the entire amount of the mortgage, which many times is in excess of the replacement cost of the house. The rationale for this rule may be twofold. First, it can be argued that between the replacement cost and the underlying value of the lot on which the residential property was built, the mortgage lender has adequate coverage to protect its interests. Secondly, unless carefully monitored, conditioning the granting of a mortgage on obtaining certain fire insurance coverage may run afoul of section 626.955(1), Florida Statute. Broadly speaking, this section provides for consumer protection measures by prohibiting any person from tying the extension of credit with the purchase of an insurance product from a favored agent or insurer.

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Agency Letterhead

Dear Lender/Broker:	
Concerning our mutual client:_	

Included herewith is a properly completed current ACORD Form 27 – Evidence of Property Insurance. As dictated in the ACORD Forms Instruction Guide, the form has been properly completed to reflect the coverage provided in the policy. Requests to add special wording that are not supported by the actual policy are not permitted on an ACORD form and such action violates the license agreement we have with ACORD. Specifically, requests to add wording such as, "full replacement cost," "guaranteed replacement cost," "100 percent replacement cost," or any similar wording are not permitted and our agency will not alter the ACORD forms to provide any language that is not supported by the policy. Additionally, once ACORD updates a form, the old form may be used for only one year. Use of an old form beyond the one-year time frame violates the license agreement signed with ACORD.

In addition to violating the guidelines established by ACORD for the use of their forms, placing wording on a certificate of insurance or an evidence of property insurance that is not supported in the policy is a violation of the Florida Statute shown below:

- 626.9541 Unfair methods of competition and unfair or deceptive acts or practices defined.—
 (1) UNFAIR METHODS OF COMPETITION AND UNFAIR OR DECEPTIVE ACTS.—The following are defined as unfair methods of competition and unfair or deceptive acts or practices:
- (a) Misrepresentations and false advertising of insurance policies.—Knowingly making, issuing, circulating, or causing to be made, issued, or circulated, any estimate, illustration, circular, statement, sales presentation, omission, comparison, or property and casualty certificate of insurance altered after being issued, which:
- 1. Misrepresents the benefits, advantages, conditions, or terms of any insurance policy.
- 5. Uses any name or title of any insurance policy or class of insurance policies misrepresenting the true nature thereof.
- 7. Is a misrepresentation for the purpose of effecting a pledge or assignment of, or effecting a loan against, any insurance policy.
- (b) False information and advertising generally.—Knowingly making, publishing, disseminating, circulating, or placing before the public, or causing, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public:
- 1. In a newspaper, magazine, or other publication,
- 2. In the form of a notice, circular, pamphlet, letter, or poster,
- 3. Over any radio or television station, or
- 4. In any other way,
- (e) False statements and entries.—
- 1. Knowingly:

- a. Filing with any supervisory or other public official,
- b. Making, publishing, disseminating, circulating,
- c. Delivering to any person,
- d. Placing before the public,
- e. Causing, directly or indirectly, to be made, published, disseminated, circulated, delivered to any person, or placed before the public: any false material statement.
- (k) Misrepresentation in insurance applications.—
- 1. Knowingly making a false or fraudulent written or oral statement or representation on, or relative to, an application or negotiation for an insurance policy for the purpose of obtaining a fee, commission, money, or other benefit from any insurer, agent, broker, or individual.

Any insurance agent or agency that provides wording on a certificate or evidence of insurance that is not supported by the policy violates the above referenced Florida Statute and risks severe penalties including, but not limited to, substantial fines by the Department of Financial Services and/or loss of their license. Therefore, this agency will not comply with a request to place wording on a certificate or evidence of insurance that is not supported by the policy. Additionally, we will report all such requests/demands by any lending institution and/or mortgage broker to the Florida Office of Financial Regulation at (850) 487-9687 or http://www.flofr.com/ and/or the Office of the Comptroller of the Currency under the U.S. Department of the Treasury at http://helpwithmybank.gov/complaints/index-file-a-bank-complaint.html, (800)613-6743

It is also illegal for a lender (or any person) to require that a customer purchase an insurance policy from a specific agent or insurer.

626.9551 Favored agent or insurer; coercion of debtors.—

- (1) No person may:
- (a) Require, as a condition precedent or condition subsequent to the lending of money or extension of credit or any renewal thereof, that the person to whom such money or credit is extended, or whose obligation the creditor is to acquire or finance, negotiate any policy or contract of insurance through a particular insurer or group of insurers or agent or broker or group of agents or brokers.

For your convenience, we have provided an extract of the loss settlement provisions of the standard homeowners policy below. Please review it so that you may determine how losses are paid. Subject to the terms, conditions, limitations, and exclusions found in the policy, certain losses are settled on a replacement cost basis up to the limit of coverage specified in the policy.

D. Loss Settlement

In this Condition **D.**, the terms "cost to repair or replace" and "replacement cost" do not include the increased costs incurred to comply with the enforcement of any ordinance or law, except to the extent that coverage for these increased costs is provided in **E.11**. Ordinance Or Law under Section **I** – Property Coverages. Covered property losses are settled as follows:

1. Property of the following types:

- a. Personal property;
- b. Awnings, carpeting, household appliances, outdoor antennas and outdoor equipment, whether or not attached to buildings;
- c. Structures that are not buildings; and
- d. Grave markers, including mausoleums; at actual cash value at the time of loss but not more than the amount required to repair or replace.
- 2. Buildings covered under Coverage A or B at replacement cost without deduction for depreciation, subject to the following:
 - a. If, at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss, we will pay the cost to repair or replace, without deduction for depreciation, but not more than the least of the following amounts:
 - (1) The limit of liability under this policy that applies to the building;
 - (2) The replacement cost of that part of the building damaged with material of like kind and quality and for like use; or
 - (3) The necessary amount actually spent to repair or replace the damaged building. If the building is rebuilt at a new premises, the cost described in (2) above is limited to the cost which would have been incurred if the building had been built at the original premises.

- b. If, at the time of loss, the amount of insurance in this policy on the damaged building is less than 80% of the full replacement cost of the building immediately before the loss, we will pay the greater of the following amounts, but not more than the limit of liability under this policy that applies to the building:
 - (1) The actual cash value of that part of the building damaged; or
 - (2) That proportion of the cost to repair or replace, without deduction for depreciation, that part of the building damaged, which the total amount of insurance in this policy on the damaged building bears to 80% of the replacement cost of the building.
- c. To determine the amount of insurance required to equal 80% of the full replacement cost of the building immediately before the loss, do not include the value of:
 - (1) Excavations, footings, foundations, piers, or any other structures or devices that support all or part of the building, which are below the undersurface of the lowest basement floor;
 - (2) Those supports described in (1) above which are below the surface of the ground inside the foundation walls, if there is no basement; and
 - (3) Underground flues, pipes, wiring and drains.
- d. We will pay no more than the actual cash value of the damage until actual repair or replacement is complete. Once actual repair or replacement is complete, we will settle the loss as noted in 2.a. and b. above.

However, if the cost to repair or replace the damage is both:

- (1) Less than 5% of the amount of insurance in this policy on the building; and
- (2) Less than \$2,500;
- we will settle the loss as noted in **2.a.** and **b.** above whether or not actual repair or replacement is complete.
- e. You may disregard the replacement cost loss settlement provisions and make claim under this policy for loss to buildings on an actual cash value basis. You may then make claim for any additional liability according to the provisions of this Condition D. Loss Settlement, provided you notify us, within 180 days after the date of loss, of your intent to repair or replace the damaged building.

Finally, requests/demands that our agency provide a copy of the replacement cost estimating form used to select an amount of coverage will not be honored. That form is a proprietary internal document of the agency and/or insurer and it will not be provided to a third party. Much like a credit report, survey, termite inspection, title search, and prior financial data obtained by a lender on their client is proprietary information, so, too, is the replacement cost estimator. Lenders who wish to obtain a replacement cost estimator may do so by obtaining the services of firms who provide this software. One such firm is www.e2value.com.

Providing Proof of Insurance Coverage to Your Lender

When property is financed, the lending institution will generally insist upon evidence of insurance in accordance with requirements in the loan agreements. While the insurance policy provides such evidence, it is rarely available by the time of the closing of the loan. As a result, evidence of insurance is often provided by a binder (also known as the ACORD 75) or by an Evidence of Property Insurance form (ACORD 27) or Evidence of Commercial Property Insurance form (ACORD 28).

The binder is a temporary insurance contract which substitutes for the policy until it is issued. Although there is less information on the binder than that contained in the actual policy, the binder represents all of the terms and conditions of the policy itself, from the actual coverages to any required notice of cancellation, and it provides proof of coverage until the policy is available. The evidence of insurance forms, on the other hand, may contain more detailed policy summary information (such as the coverages and limits provided by the policy), but they grant no rights to the recipient and are provided for informational purposes only.

It has recently come to our attention that some national lenders are refusing to accept the current (2006) editions of the ACORD 27 and ACORD 28 as evidence of insurance and are insisting that prior (2003) editions of these forms be provided. As your agent, we are unable to provide the prior editions for the important reasons explained below.

First, the older editions of these forms inappropriately suggested that the form recipients were being provided with certain rights under your insurance policy, and the forms were revised because they were not in compliance with the laws and legal requirements of most states. The current editions of these forms now include statements clarifying that the forms are for informational purposes only and confer no rights to their recipients. Under the insurance laws of most states, only insurance policies and binders can confer policy rights — and those documents must be filed with state insurance regulators.

Second, any agent or insurance company who provides a lender with a document purporting to extend policy rights could be in violation of state insurance laws if it is not filed as a *policy* form, and the ACORD 27 and ACORD 28 are not filed as policy forms.

Third, these forms are created, published, and owned by the ACORD Corporation. According to the licensing agreement that allows us to issue their forms, a prior edition of a form cannot be used beyond one year after the date of publication of a new version of the form. Therefore, the licensing agreement bars use of the previous editions of the ACORD 27 and ACORD 28.

Binders are often provided to lenders as proof of coverage, and the insurance laws of most states require lenders to accept binders for this purpose in lieu of the actual policy. The ACORD 27 and ACORD 28 forms are, in contrast, provided simply as a courtesy to the lender to summarize more policy detail than is included in the binder. However, only the binder or policy actually grants policy rights sought by lenders.

While binders provide sufficient proof of coverage to lenders, it should be noted that insurance industry representatives recently spent more than a year discussing the potential development of an expanded binder form for use by the lending community. The proposed expanded binder would have extended rights as only a binder or policy can, while also incorporating additional policy details of interest to lenders. The insurance industry's offer was unfortunately declined by some lenders who continue to request certain documents that insurers and agents are simply unable to provide due to legal restrictions.

Although state insurance laws and contractual licensing restrictions prevent us from providing certain outdated forms, we would be pleased to provide your lender with an insurance binder (ACORD 75) and/or the current versions of the evidence of insurance forms (the ACORD 27 or ACORD 28).

If you have any questions or if we can be of any further assistance, please contact us.

Last Updated: December 28, 2009

Agency Name Address City, State, ZIP

TO: <<<Insert Lender Name>>> RE: <<<Insert Customer Name>>>

Loan Number: <<<Insert Loan Number>>>

Date: <<<Insert Date>>>

On the advice of our attorney, our independent insurance agents association, and our professional liability insurance company, we are unfortunately unable to provide your firm with a copy of the replacement cost estimator (RCE) that our agency has prepared for the above referenced customer. Additionally, several of the insurance companies that we represent have advised us that the RCE is not to be shared with any third party; sharing the RCE could jeopardize our contract with the insurance company.

Your firm prepares and obtains various report and documents in your loan underwriting process, such as a credit report, prior financial records to include Internal Revenue Service (IRS) returns, prior checking and savings account statements, a list of assets, and more. Just like those documents and reports are for the internal use of the lender and are proprietary documents, so, too, is the RCE performed by this agency.

We performed the RCE using standard insurance industry software that provides an <u>estimated</u> replacement cost of the structure. The RCE is not a guarantee of the adequacy of coverage after a loss; no document can guarantee that. It is our agency policy to insure for 100 percent of the <u>estimated</u> replacement cost of the structure and we have done that in this case.

If you would like to perform your own evaluation of the <u>estimated</u> replacement cost of the structure, we recommend that you utilize the services of RCE vendors such as e2Value or Marshall & Swift. Alternatively, you may entertain the services of a firm that specializes in insurance replacement cost estimates; one such firm is Castle Data Services. Should you care to use any of these services and obtain your own valid insurance replacement cost estimate, after consultation with our customer, we will submit your estimate to the insurance company for their consideration.

Sincerely,

Management

Replacement Cost Estimator: Provide it to Lenders?

David Thompson, CPCU, AAI, API

Question: David, thanks for all of the information about dealing with lender requests for insurance documents. What are the implications to our agency if we do provide a copy of the Replacement Cost Estimator (RCE) to the lender? Jody. (*Name and question used with permission.*)

Answer: It's a good question, Jody, and one I am receiving a lot today. The answer, right up front, is that an agency should not provide the RCE to a lender. A reply such as, "On the advice of our professional liability insurance company and on the advice of our legal counsel, we are unable to provide the document(s) that you have requested." FAIA has prepared <u>a letter</u> that can be used in this specific case.

SwissRe, FAIA's lead E&O carrier recently stated this:

Agents should not provide copies of any RCE, ever. The agency has no relationship with the lender and is under no obligation to do so. We don't recommend that they provide it to the customer either. If they don't provide it to the customer, then they shouldn't provide it to anyone. It is the lenders job to determine what they think the value of the house is, the agent is not a real estate appraiser. At most the can provide an ACORD form certificate of insurance and nothing else.

In addition, taking on a (voluntary) role advising the lender is ill-advised. Valuation issues regarding the adequacy of limits in place drive a lot of our commercial exposures. Most, if not all, lenders confirm property valuation before agreeing to loan money, so the lender is in a much better position to evaluate property value than an insurance broker. This sounds like the lenders have been recently been to some seminar where the advice was given to obtain the RCE's from the agents/brokers.

An additional thought: every time the issue of limits/replacement cost is raised, that probably is a moment where the agent/broker should respond with a comment to the effect that,

"Our office is not able to evaluate, and has not evaluated, the actual cash value or replacement cost of this property. The property owner and lender are in the best position to evaluate the value of real estate. We urge you to have the property (re)appraised by a licensed appraiser on a regular basis to ensure that the limits in place are, and remain, adequate.

Additionally, some insurance companies (Citizens being one) have issued bulletins stating that the agency is not to provide the RCE to a third party. Violating their guidance could jeopardize the contract between the agency and company.

Remember, most importantly, that the RCE is only what the name says - an estimate. Calculating the replacement cost of a structure is not an exact science and if you were to use three different RCE vendors on the same structure, you'd get three different figures. Likewise, if you asked three different builders to prepare an estimate to build a structure, you'd get three different figures.

Next, the RCE should be prepared based on complete and accurate data. Without the proper information to complete the RCE, the final product can't possibly be accurate. Once the estimated replacement cost is determined, the agency should provide coverage that is at least equal to 100 percent of the estimated replacement cost. There is simply no reason not to insure for 100 percent of the estimated rebuilding cost.

There are no statutes that deal with this issue. Additionally, while some lenders may say, "Guidelines require us to get a copy of the RCE," there is no such requirement in the Fannie Mae guidelines, those that a majority of lenders fall back on. Furthermore, even if a lender did say, "Our guidelines require a copy of the RCE," there is no obligation of an insurance agency to comply with guidelines drafted by a lender.

Let's digest this a bit more. Suppose you were to receive any of the following requests from a lender:

- "We need a copy of the four-point inspection to verify the condition of the structure."
- "In order to verify the information given to us by our borrower, please provide a copy of the homeowners policy application so we can compare the information."
- "Our guidelines require that you provide us with the CLUE report on the applicant."
- "For financial underwriting on the loan, we need a list of all the assets of the applicant; please provide a copy of the jewelry schedule."

Would you even consider providing any of this to the lender? Certainly, you would not.

Now let's turn the table on the question. The agency could make the following requests to the lender:

- "We underwrite the customer for credit information. Please provide us with a copy of their loan application that includes their credit report, six months of pay stubs, prior tax returns, and list of assets."
- "To verify that there is no existing damage from termites, please provide a copy of the termite inspection."
- "A house with a low market value and higher replacement cost is a moral hazard, therefore please provide a copy of the appraisal."

The lender would certainly not provide this information to the agency.

It's well established today that many appraisers no longer provide an estimated replacement cost on their appraisal. I personally spoke with one appraiser who said, "I know a lot about the market value of a house but, I'm not a contractor and I know next to nothing about rebuilding costs. I'm not putting my license and career at stake by guessing at the replacement cost of a house." The same approach is taken by many insurance agents who are just that, an insurance

agent and not a contractor. The RCE is little more than an estimate and many agents take the approach that appraisers today take. If the lender wants to determine the replacement cost of a structure, they have resources available to them to do that. Those resources would be to pay for an appraisal that includes the replacement cost, contracting with firms that specialize in replacement cost estimates (<u>Castle Data Services</u> is one such company), or use a service such as <u>e2Value</u>, which provides replacement cost software.

While an agency certainly does not want to stand in the way between the customer and a loan closing, the agency must take all steps to protect themselves. Providing the RCE to anyone outside the agency does increase the possible E&O exposure to the agency. Certainly, requests to provide the RCE coupled with a request for wording such as "100 percent replacement cost," "guaranteed replacement cost," "full replacement cost," and similar wording can't be honored. Placing such wording on an Evidence of Insurance misrepresents the policy and violates Florida Statute 626.9541.

My practice, if I were in your shoes, would be to refuse the lender request for the RCE. If you decide to do it, though, I'd first get the written permission of the customer. I'd require the lender to sign a statement indicating that they understand that the RCE is only an estimate, not a guarantee that coverage is adequate. Then on the RCE, I'd use this disclaimer in about 24-point font:

Building and personal property coverage limits are estimates only and were arrived at based on information provided by the policyholder and/or industry standard software used to estimate replacement costs. The actual cost to rebuild the structure or replace the personal property may exceed the policy limits, especially in circumstances where a catastrophic event has disrupted the normal supply of materials, labor, and resources. The agency makes no assurances or guarantees that the policy limits provided will be adequate to rebuild the structure or replace personal property. If there is doubt about the adequacy of the policy limits, the policyholder should obtain a professional appraisal or obtain the services of a qualified company or builder who is able to provide replacement cost estimates.

I ran your question by several other agents and a company representative. Their responses are below.

Agency vice president. (14 years experience):

Lenders and loan brokers have given me multiple reasons for requesting the RCE and my reply is always NO.

(Just for fun, Quote the Rolling Stones: "You can't always get what you want.")

One lender said it was required by "the feds." I said, "Really show me the paper". Nothing came.

I told another lender, "We don't have one, we use the appraisal from the prior lender" and to get their own appraisal or RCE.

I told another lender, "I need \$250 and a signed statement from you acknowledging the RCE was just an estimate and was not binding". They said "OK, we can move forward without that item".

Recently, I have been using excerpts from FAIA, DFS, Privacy and Underwriting letters to quite lenders.

Bottom line, until I see a legal requirement for something other than Evidence of Insurance or declarations page, I will continue to disregard and/or send rejection letter.

Stand your Ground.

Agency owner. (25 years experience):

The RCE is the agents work product. If the lender wants an RCE they are welcome to create an RCE of their own or obtain an appraisal. I have never released an RCE to a lender and have instructed staff likewise.

The lender is provided the Evidence of Property. If they are unhappy with the limit on that document, once again, they can provide the agent with an appraisal.

Agent. (12 years experience.)

We have never released the RCE to a lender. We hear threats of, "We won't close the loan without it." We have never had a loan not close over our failure to provide the RCE. When we explain this to our customer, they understand and typically support us against the lender.

Agency owner. (20 years experience):

Nothing good could come from supplying that document. Stand your ground!

Agent. Personal lines manager. (14 years experience):

I don't do it, period. I just tell the lender, "I don't care what others do; I am not releasing the RCE to you."

Company vice president of underwriting. (30 years experience):

If a lender wants a copy of the RCE, why don't they just purchase the software and run it themselves! The RCE should have a disclaimer on it. From an E&O perspective I'm not sure it's wise to give them a copy.

From the company side, I can tell you that we are in the process of changing RCE vendors. When the implementation is complete, it will be completely integrated in the rating process. The agent will have the ability to make modifications, but the calculation will be electronic and will not print with the application. There will be no way for the agent to give a copy to another party.

Agent. Agency manager. (27 years experience):

I don't release the RCE to anyone except the insured if they ask for it. Any time I provide a copy to the customer I place a disclaimer on it stating that the figures are estimates only and not a guarantee of coverage. I've never sent the RCE to a lender and routinely "just say no"

The bottom line, Jody, is the ultimate decision is yours. A majority of agents don't provide the RCE to a lender. If you do, I'd urge caution and use some of the suggestions above.

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