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## Insurance Clause Protects REO

By RONALD REITZ

*Mr. Reitz, vice president of insurance services for GMAC-RFC's Asset Resolution Division, writes about the special value to lenders of a particular insurance clause.*

In recent years, lenders' losses on real estate owned (REO) properties have increased dramatically. Most lenders do not like to hold REO properties on their books for several reasons, one of which is the costs involved in obtaining possession, repairing the asset for market, and marketing the asset.

When a property becomes REO, lenders have historically performed various critical functions including performing the initial inspection, approving the repair bids and commencing work on the asset. Obviously the more money spent on repairs the higher the loan loss severity. However, lenders have other options.

Lenders can become more aggressive at looking for damage that may be recoverable under a hazard insurance policy. Much of the damage that is discovered at the initial inspection is damage that can be claimed against the former borrower's policy. Of course, not all damage is

insured and it takes an experienced mortgagee-interest claims adjuster to ascertain the differences.

The key is that lenders are insured under the borrower's homeowner's policy and listed as the mortgagee. Most investors and lenders require a 438 BFU NS Lender's Loss Payable Endorsement. This is also known as a "Standard" or "Union Mortgage Clause", and is a separate insuring agreement between the lender/mortgagee and the insurer.

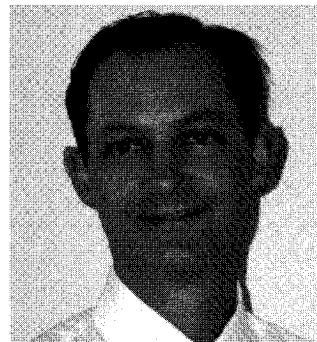
This is a very powerful document to the mortgagee. Basically, this provides coverage to the lender for any and all acts of the named insured. This is different than the coverage to the borrower (named insured) because it insures the lender for intentional acts of the borrower.

For example, if the borrower were to intentionally set his house on fire and attempt to recover insurance proceeds, the borrower would be denied coverage because the damage resulted from an inten-

tional act of the named insured.

However, if the lender were to file a claim, the lender would be covered because the 438 BFU NS protects the lender against the acts of the named insured. It makes no difference whether the peril is fire or theft or vandalism, the lender is still insured.

### POINT OF VIEW



—Ronald Reitz

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Paragraph two to the 438 BFU NS addresses this issue.

Another provision of the 438 BFU NS protects the lender if the insurer does not issue notice of cancellation within a specific number of days. For instance, if the insurer were to attempt to cancel the policy for non-payment of premium, the insurer must send the lender notice between 60 and 120 days from the due date of the premium. Lenders like this language because often times after the lender has updated its system to issue a check for the premium, the borrower ends up paying within 60 days. This leads to unnecessary work for the lender.

Typically, insurers do not send the notices between the 60 and 120 day time period. This would mean that coverage to the lender would remain in effect until the proper notice is given. Paragraph three of the 438 BFU NS addresses this issue.

Yet another provision of the 438 BFU NS, paragraph one, states that the lender's successors and assigns are covered. This is important when servicing transfers from one servicer to another. This is also

important in today's world of mergers and acquisitions.

For the reasons set forth above, insurers do not like the 438 BFU NS. It means that they are being asked to pay more claims to lenders. Therefore, insurers will seek other ways to keep the money the lender is entitled to.

Insurers will attempt to delay claims for as long as possible. Insurers will attempt to reduce a claim to as little as possible by unreasonably applying enormous amounts of depreciation to the claims. Insurers will also attempt to deny claim,

stating that the majority of the damage is not covered because it falls under the infamous category of wear and tear.

For instance, carpet stains are often classified as wear and tear in the eyes of the insurer. But, doesn't it make sense that the stain must have been a result of either an accident or an intentional act? What other way could the stain have occurred? If the stain was an accident, then that is one of the primary reasons we as lenders have insurance. If the stain was the result of an intentional act, then the lender would be

covered, *if* the lender had a 438 BFU NS attached to the policy.

There are many other tactics that insurers will use to not pay the claims, or to pay as little as possible. These arguments are best left to professional claims adjusters who specialize in mortgagee-interest claims.

Recently, some insurers have attempted to "retire" the 438 BFU NS. Insurers are offering alternatives such as a simple loss payee clause. This does not afford the same protection to the lender as the 438 BFU NS. In the

many years that I have been representing lenders in their mortgagee-interest claims, I have never seen such a powerful document as the 438 BFU NS. I fully understand why a mortgage lender is reluctant to fund a loan unless the 438 BFU NS is attached - because without it the lender is not adequately protected.

The next time you read an article about retiring the 438 BFU NS, remember to look at the source and the source's motivation. Is it from an insurer that does not want to pay claims?