How serious is the situation? Institutions can monitor their potential exposure by keeping a close watch on borrower performance in regard to loan covenants. Is the borrower providing acceptable proof of Property and Casualty insurance? Paying the premium for these coverages? Is he or she making mortgage repayments in a timely manner? If the borrower is non-performing on one of the loan covenants, it is likely that they will ultimately be non-performing on others. If they are not paying their mortgage, it is highly likely they are not staying current on insurance payments, or purchasing the specific coverages required by the lender. If they stop paying their insurance premiums, it is likely that they are on their way to default and repossession.

Banks are repossessing properties in increasing numbers. Their loan loss reserves are expanding accordingly, as are FIs’ schedules of real estate-related assets potentially at risk. It seems that daily another lending institution is announcing a large write-off. As these at-risk portfolios continue to grow, banks and other lending institutions will need to increase their vigilance and ensure that their interests in these properties are covered in an efficient, economical and well-structured manner.

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The insurance markets in the US and London have responded by offering products that encompass both MI and REO/Force Placed coverages. These products can also be purchased in a handful of domestic markets. While some insurers combine these solutions under a single insurance contract, others offer them as separate products, with distinct rating methodologies and coverage requirements. To help you determine which approach might be more appropriate to your situation, we examine these coverages separately.

**Mortgage Impairment (MI)**
An MI policy is essentially contingency-based E&O coverage that is triggered by property damage. The error/omission? Failing to make sure that borrowers maintain proper insurance for their properties. MI policies are designed for FIs that are primarily engaged in granting house purchase loans, but can also include commercial property lending. Prime MI candidates include commercial banks, credit unions, life companies, pension funds, mortgage banks and public development agencies involved in primary mortgages as well as subprime, secondary or serviced portfolios. This coverage is applicable in the following scenarios.

- A mortgage is performing, but the borrower has either no insurance in place or the insurance in place is not broad enough to cover all perils required by the lender.
- A mortgage is performing, but the lender did not obtain proof of insurance from the borrower.
- Non-performing mortgages.
- Foreclosed properties.

MI policies cover physical loss or damage to the FI’s interest in a property when there is a problem with (or absence of) the insurance the borrower is required to purchase in their loan closing procedures. This includes mandatory flood insurance. MI policies will cover the unpaid principal balance when the borrower has failed to adequately insure.

MI can also cover various Professional Liability or E&O losses on a claims-made basis, including cases where the lender (mis)handles the placing of insurance for the borrower or forgets to renew the policy, or where real estate tax liability is involved.

Balance of Perils coverage can be purchased for mortgages that are owned (rather than merely serviced) by an FI. This coverage protects the bank from a peril for which insurance is not required in the mortgage contract (for example, California earthquakes). Balance of Perils coverage is comparable to a Difference in Conditions (DIC) Property placement.

MI underwriters generally require an application and pertinent underwriting information, including the ratio of residential to commercial loans. They also want a breakdown of all mortgages according to how insurance is handled: is the FI insuring its own interest, or handling insurance on behalf of others? Are others handling the insurance on the FI’s behalf? Underwriters will also require a list of values in CAT-exposed states as well as details of the largest loans.

To receive the best marketplace treatment, an FI needs to have a tracking system in place to help ensure that borrowers have sufficient insurance in place at the inception of each loan. FIs pay a higher rate if they don’t systematically check at renewal.

This is a contingency-based coverage, with the trigger for a claim being physical damage.

**REO/Force Placed**
These policies protect the FI’s portfolio when a borrower defaults and the FI decides they are unlikely to be maintaining insurance. The property is moved to a Force Placed schedule for the remainder of the life of the loan. If the FI actually repossesses, then the property moves onto an REO (or foreclosed or repossessed) schedule until the FI sells the property. Banks looking to protect their financial interests by insuring either the unpaid principal loan balance or the replacement cost of the property will be interested in this coverage.

This product is usually written per location. Coverage is generally on an All Risks basis, and can include Earthquake, Flood or Wind coverage. It can also include Liability coverage.
Required underwriting information includes the number of mortgages, average value of mortgages, percentage of domestic and commercial loans, number of foreclosures and procedures taken when property becomes vacant.

REO/Force Placed coverage is rated along the same lines as a normal Property placement, and is usually subject to similar fluctuations in the market. This product is generally priced with a minimum-and-deposit premium then adjusted either monthly, quarterly or annually at a pre-agreed rate, depending on the size and nature of the account.

**How Can Willis Help?**
Willis has a facility in London for both MI and REO/Force Placed products. Both coverages are placed with Lloyd’s underwriters who have 40+ years of experience writing this business and are among the market leaders in terms of product knowledge and breadth of coverage. There are several key features of the Willis program that are unique in the marketplace.

- The proprietary reporting and billing systems simplify the administration of the properties insured under the program.
- The expansions of coverage we have negotiated with carriers in London broaden the classes of assets that can be covered.
- Simplified reporting systems and cost allocation models are built in to the programs.
- Values can often be covered automatically without prior underwriter approval.

Accessing the facilities in place for both these products, we can address the needs of both large and small accounts with the flexibility to cover just certain portfolios or subsidiaries, rather than an entire FI portfolio.

Given the current mortgage climate, we urge clients to evaluate these coverages. If the coverages are already in place, FIs should be sure that their programs are fully responsive to their current risk profile. More detailed analysis of the coverages is available from your Client Advocate® or the Willis Associates listed below.