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## Mortgage Banker and Mortgage Broker Insurance Discussion

There are significant differences in the requirements for insuring mortgage bankers and mortgage brokers. This discussion will hopefully assist you in understanding the basic structure of the industry, that includes mortgage banking and mortgage brokering, by delineating between mortgage holders errors and omissions, mortgage impairment, forced placed coverage, mortgage banker bond and mortgage banker E&O.

### Mortgage Broker

First off, mortgage brokers are different than mortgage bankers. Mortgage brokers accept applications from borrowers and attempt to find the best rate and product for that borrower from the list of their contracted lenders. Once they identify the right lender for the borrower, they submit the application to the lender and the lender performs the underwriting, funds the loan and either holds it as an investment or sells it to other mortgage investors.

### Mortgage Banker

A mortgage banker will accept an application from a borrower and underwrite and fund the loan themselves utilizing a line of credit referred to as a warehouse line of credit.

The mortgage banker will then sell the loan, typically within 30 days, to an investor of mortgages. Many times there is a prearranged investor for the mortgage so the funding and sale is close to being simultaneous. Investors of mortgages come in many shapes and sizes. You may be familiar with the United States Government-sponsored enterprises – Fannie Mae, Freddie Mac and Ginnie Mae. There is also a network of private mortgage investors which include Wells Fargo, Bank of America, PNC and many smaller regional and local banks. Once the loan is sold to a mortgage investor, the mortgage banker then takes the funds received from the sale and repays the line of credit (warehouse lender) which was utilized to fund the loan. Once the warehouse line is paid off, the process starts all over again. Many mortgage bankers have a significant warehouse line of credit and as such, they can have several loans funded or about to be funded at the same time.

### Insurance for Mortgage Bankers

The mortgage banker's business partners mentioned above (Fannie Mae, Freddie Mac, Ginnie Mae and private investors such as Wells Fargo and PNC ) including their warehouse lenders have very specific **mortgage banker bond** and mortgage banker E&O requirements. Mortgage brokers, on the other hand, do not fund loans and do not share the same type of relationship with their business partners as mortgage bankers. In fact, mortgage brokers have different business partners than mortgage bankers as they do not have warehouse lenders and they do not sell loans to the likes of Fannie, Freddie and other private investors such as Wells Fargo. It is this difference that relieves the requirement for liability insurance for mortgage brokers as well as fidelity bond, mortgage impairment and forced placed coverage for mortgage brokers.

As far as Stateside Underwriting Agency knows, the only requirement for liability insurance for mortgage brokers is a state requirement by Colorado which requires any Colorado licensed mortgage broker to carry individual mortgage broker liability insurance in the amount of \$100,000 per Claim and \$300,000 per aggregate excess of a \$5,000 deductible. This limit is a per individual licensed broker limit. The regulation requires each broker of a firm to carry their own mortgage broker liability insurance policy. Reverse mortgage brokers can carry a higher deductible of \$20,000. To read more about the State of Colorado requirements, please go to the Colorado Department of Regulatory Agencies at [www.dora.state.co.us/real-estate/mortgage/EOProviders.htm](http://www.dora.state.co.us/real-estate/mortgage/EOProviders.htm). Despite the fact that the State of Colorado is the only governmental or non-governmental organization to have documented requirements for liability insurance for mortgage brokers, Stateside Underwriting Agency highly recommends mortgage company errors and omissions for any mortgage brokers. Furthermore, it is feasible other states will follow the lead of the State of Colorado and require liability insurance for mortgage brokers.

Unlike the loose requirements for insurance for mortgage brokers, there are very specific requirements for fidelity bond for mortgage bankers and liability insurance for mortgage bankers. As mentioned above, the standards for the insurance requirements for mortgage banker bond and mortgage company errors and omissions insurance emanate from Fannie Mae, Freddie Mac and Ginnie Mae. The mortgage banker fidelity and errors and omissions requirements can be found for Freddie Mac at [www.allregs.com/tpl/Main.aspx](http://www.allregs.com/tpl/Main.aspx), Fannie Mae at [www.allregs.com/efnma/toc/toc.asp?path=fnma/selling](http://www.allregs.com/efnma/toc/toc.asp?path=fnma/selling) and Ginnie Mae at

[www.ginniemae.gov/guide/pdf/chap03.pdf](http://www.ginniemae.gov/guide/pdf/chap03.pdf). These requirements are very similar and in many cases, these are the insurance requirements for mortgage bankers to which most of the private investors of mortgages (PNC, Wells Fargo, etc...) adhere.

The Freddie Mac, Fannie Mae and Ginnie Mae mortgage banker E&O and fidelity requirements are often times misunderstood. We would like to provide a few tips on making sure the mortgage banker bond and errors and omissions insurance meet these requirements. First off, the errors and omissions requirements are not professional liability for mortgage bankers or mortgage brokers and as such, a standard professional liability policy would not meet investor or GSC requirements. With respect to the fidelity bond for the mortgage banker requirement, the bond should be a modified Form 15 bond. The bond should be modified to provide a clause which would provide coverage for a direct financial loss sustained by Fannie Mae, Freddie Mac, Ginnie Mae and private investors of mortgages due to the Theft by any partner, Sole Proprietor or Major Shareholder. The nuance here is that standard Form 15 bonds do not provide coverage for theft by the owners of the organization as covering a theft by the owner would be a moral hazard. Despite this apparent moral hazard, the government sponsored entities and private investors or mortgages require this clause to be present in the mortgage banker bond.

Another important aspect of the mortgage banker bond is the ability of the carrier to include Loss Payee language for a variety of private investors of mortgages, warehouse lenders and of course Fannie Mae, Freddie Mac and Ginnie Mae (who are considered for purposes of this conversation, non-private investors of mortgages). Many times we get requests to add an investor of mortgages or a warehouse lender immediately to the fidelity bond for the mortgage banker or loans scheduled for that day cannot be closed. Stateside Underwriting Agency is set up to respond immediately to this request and is able to issue a Loss Payee to both the mortgage impairment policy as well as the mortgage banker bond.

One area of significant confusion when insuring mortgage bankers is the reference Fannie Mae, Freddie Mac and other private investors make to errors and omissions coverage and mortgagee's errors and omissions coverage. This errors and omissions is not the same as mortgage banker E&O, mortgage banker liability insurance or mortgage banker professional liability. The main difference between the two is that when Fannie Mae, Freddie Mac and other private mortgage investors refer to mortgagee's E&O or errors and omissions, they are referring to the very specific errors and omissions that can occur during specified servicing operations. These errors include failures in:

- Obtaining or maintaining hazard insurance on the property
- Determining whether mortgaged premises are located in a Special Hazard Area
- Maintaining FHA insurance, VA guaranty, or private mortgage insurance
- Payment of real estate taxes
- Complying with the reporting requirements of FHA, VA or MI's

This type of errors and omissions could be referred to as "named perils" coverage and differs from mortgage banker liability insurance or mortgage company errors and omissions in that the latter policies are referred to as "all perils" or "all risk" coverage except for those items which are specifically excluded from the mortgage banker professional liability insurance.

In summary, when Fannie Mae, Freddie Mac or other private investors refer to an errors and omissions requirement, they are referring to the very specific coverage described above. This coverage is also referred to as mortgage interest, mortgagee's errors and omissions, investor required errors and omissions or mortgage holders errors and omissions and not mortgage banker professional liability insurance.

Stateside Underwriting Agency addresses the Fannie Mae, Freddie Mac and private mortgage investors required errors and omissions insurance by offering clause 9 of our mortgage banker bond. This clause provides for the 3rd party liability/errors and omissions coverage required by said agencies and investors. This enables the mortgage banker to be compliant by purchasing the Stateside Underwriting Agency mortgage banker bond versus having to purchase the fidelity bond for mortgage bankers and mortgage banker professional liability or mortgage broker professional liability.

Other important insurance for mortgage bankers include forced placed property, forced placed general liability and mortgage impairment coverage. These coverages compliment each other and are mostly created for mortgage bankers who sell their mortgages but retain servicing rights. The mortgage impairment coverage protects the mortgage banker who also services loans from liability arising from damage to the mortgage interest in a property as a result of uncollectable or non-existence of insurance against the perils that are required by the borrower - including mandatory flood insurance.

The mortgage impairment policy essentially provides protection for loss to the insured's interests for up to 90 days from the date the insured mortgage banker learns there is no hazard/homeowners insurance on the property. Once the insured mortgage banker determines homeowners insurance is not in place, the mortgage impairment policy provides an additional 90 days protection for the Insured to force place the property insurance. So, in summary, mortgage impairment provides coverage for that period when the Insured does not know the homeowners insurance has lapsed and 90 days from the date they learn the coverage has lapsed.

If the insured mortgage banker forecloses on the property, the mortgage impairment policy can serve to protect the Insured's interest (or interest for those they are servicing on behalf of) for 90 days from the date the insured mortgage banker takes title to the property. Despite this 90 day feature, it is recommended that the Insured mortgage banker utilize a forced placed policy to force place property insurance on uninsured mortgaged property as soon as they learn the homeowners insurance has lapsed. We also recommend the Insured force place property and general liability as soon as possible (and not wait 90 days) upon taking title to the property.

Stateside Underwriting Agency has comprehensive forced placed property and general liability programs for mortgage bankers, mortgage loans servicers, community banks and large regional banks. Under the forced

placed program we can cover commercial and residential vacant and occupied properties. We also cover real estate owned (REO) at lower rates than forced placed mortgaged property.

Hopefully the above is useful in determining the liability insurance needs for mortgage bankers as well as mortgage brokers liability insurance needs. Some keys points: 1) mortgage broker liability insurance is the same as mortgage broker professional liability, 2) mortgage bankers have a warehouse line and mortgage brokers do not 3) mortgage bankers are required to carry a fidelity bond for mortgage bankers as well as mortgagee's errors and omission (aka mortgage holders, investor required E&O, or mortgage interest coverage) 4) in addition to fidelity bond and mortgagee's errors and omissions, which are required coverages, we recommend mortgage bankers to carry all risk liability insurance for mortgage bankers, forced placed property insurance program for mortgaged property and forced placed property and forced placed general liability for titled or foreclosed property.

Stateside Underwriting Agency's staff and management are skilled in the placement of insurance for mortgage brokers and insurance for mortgage bankers as well as the placement of mortgage impairment, forced placed coverage, forced placed general liability, mortgage banker bond and mortgagee's errors and omissions so please call to discuss the specific mortgage broker and mortgage banker insurance needs of your mortgage banking and brokering clients.

**Custodial Errors and Omissions (Custodial E&O)**

One of the coverage sections of the mortgage impairment policy which is becoming more and more of a concern with GSE's is Custodial Errors and Omissions or otherwise known and Custodial E&O. Custodial E&O covers Losses incurred due to the verification, certification, maintenance and custody of documents concerning loans sold to GNMA, FNMA or FHLMC. Custodial E&O or Custodial Errors and Omissions in many instances required to be carried by by FNMA, GNMA or FHLMC. We are seeing much higher Custodial E&O limit requirements from the GSE's of late which is due to the current uncertainty in the real estate marketplace.

The written agreement referred to in the coverage section of the custodial E&O clause (H) is the written custodial agreement between the assured as the custodian and the agencies set out as owner or guarantor, or any written procedure guide document of brochure that takes the place thereof.

An important warranty in the custodial E&O section warrants that the assured as Loan Custodian shall assume no responsibility for the sufficiency, genuineness, legality or validity of any Mortgage Document.

The following questions are the ones most relevant for quoting Custodial E&O:

Custodial E&O questions:

Has the Applicant agreed to undertake any Custodial Services for FHLMC, FNMA and / or GNMA?

**Yes / No** If "yes", provide the following:

- (a) Number of loan files the Applicant holds in custody for FHLMC:
- (b) Number of loan files the Applicant holds in custody for FNMA:
- (c) Number of loan files the Applicant holds in custody for GNMA:
- (d) Description of the location, fire protection, & security provided by Applicant for these files:
- (e) Details of back-up records in existence in case of loss to the original files:

Please remember that in order to obtain Custodial E&O, the Insured often times must purchase a mortgage impairment policy. Please contact Stateside for a mortgage impairment application.

Features on our mortgage impairment policy are as follows:

**SUMMARY OF AVAILABLE COVERAGES:**

Any combination of sections outlined below may be purchased, provided Sections A and/or C are included.

**Section A(1): Physical loss or damage from 'Required Perils'.**

Covers loss to the Assured's interest through the uncollectability or non-existence of insurance against perils that are required by the borrower – including mandatory flood insurance – in the Assured's loan closing procedures.

**Section A(2): Liability.**

Covers errors and omissions, on a claims made basis, relating to the Assured's handling of physical damage insurance and homeowner's insurance covering the real property of borrowers. The Assured's defence costs are also provided for within the limits.

**Section B(1): Real estate tax liability.**

Covers the Assured against errors and omissions relating to non-payment of real estate tax by the Assured on behalf of a borrower.

**Section B(2):**

Section suspended as coverage incorporate in Section F.

**Section B(3): Life and Disability insurance.**

Covers the Assured against errors and omissions arising out of the Assured's procurement and maintenance of life or disability insurance on behalf of a borrower.

**Section B(4): Flood Disaster Act 1973 liability.**

Covers the Assured against errors and omissions claims arising out of Assured's duty to determine whether or not a particular property is in a flood zone.

**Section B(5): GNMA procedures.**

Covers the Assured, as mortgage servicer, against errors and omissions should the Assured fail to comply with GNMA procedures which result in a guarantee being lost.

**Section B(6): Title Errors & Omissions liability.**

Covers errors and omissions arising out of the Bank's failure to obtain the correct title insurance, or a title abstract or legal opinion as to a title depending on custom and practice.

**Section B(7): Recordation Errors & Omissions.**

Covers errors and omissions arising out of the Bank's recordation of a loan as a servicer of a loan sold to GNMA/FNMA/FHLMC

**Section B(8): Satisfaction of Mortgage liability.**

Covers errors and omissions arising out of the Bank's connection with the satisfaction of a mortgage on property in which the Assured holds an insurable interest.

*(Section B coverages are on a 'claims made' basis and, in addition, provide for the Assured's defence costs, within the limits)*

**Section C: Physical loss or damage from Balance of Perils.**

Provides insurance should the security for the loan suffer a physical loss from any other cause other than outlined in A(1), and the Assured be unable to recover the loan from the borrower.

**Section F: Loss of Veterans Administration, Federal Housing Administration, Small Business Administration and private mortgage guarantee coverage.**

Covers loss to the Assured's interest should he fail to provide to a 'mortgage guarantee' agency or Insurance Company its property notice of loans in arrears.

**Section G: Loss of Security Interest due to Defective Title.**

**Section H: Custodial Errors and Omissions.**

Losses incurred due to the verification, certification, maintenance and custody of documents concerning loans sold to GNMA, FNMA or FHLMC

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CLAIM DETERMINATION...Any claim is subject to the actual policy wording/endorsements and the coverage for a claim shall be determined using the policy wording.

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A New Approach to Old Fashioned Service®

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