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EXHIBIT NO. 5
 DATE 3/11/05
 BILL NO. HB 557

Don't Insure for the Mortgage Amount (Regardless of What the Bank Says)



Bill Wilson

Abstract

Every agency has experienced this to one degree or another: A client buys a house and the replacement cost of the dwelling is considerably less than the mortgage amount. The insurer refuses to issue a policy with a Coverage A amount greater than the replacement cost, but the lender insists on a policy limit equal to the mortgage amount....

Here's a typical situation:

Q. "We need your help! We're getting beat up by lenders insisting that we insure a home for the loan amount rather than replacement value. In our area, selling price values are soaring but replacement values are steady. People are refinancing with lower interest rates, starting a vicious battle between the loan officer (representing the lender) and us (representing the insurance company).

"Here lies the problem: the loan officer will absolutely accept nothing short of the loan amount and they become angry and very threatening if we don't do exactly as they demand. The insurance companies demand some type of proof as to why we are requesting an increase (and a refinance is not the reason).

"A typical situation is as follows: The bank faxes our office a request to change the mortgage clause and increase coverage to the loan amount. We respond that we need an appraisal showing replacement value from them to increase coverage. They normally supply an appraisal which agrees with our current coverage. We then advise them that we cannot increase coverage as we currently insure at replacement value and that their appraisal agrees. Now the trouble starts. We normally receive multiple calls from the loan officer calling us illegal, unprofessional, not serving our client, threatening to take the business away from us, and on and on. The calls start at the CSR level, then move up to the personal lines manager, and sometimes moves up to me, the owner, with each one of us explaining the same thing.

"This problem is only getting worse and I'm afraid it could get a lot worse.

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I'm concerned that banks will use this issue as leverage to rewrite our policies into their markets.

"I contacted the local insurance department office and he advised I could lodge an individual complaint on each situation with them. We're getting about 7 to 8 requests per day of which 1 or 2 can get real ugly."

A. The lender's position is understandable, but misguided. Clearly, they want to protect their investment. That investment consists of two components: (1) the real estate (land, home, outbuildings, etc.), and (2) the loan itself. Insurance is the mechanism designed to protect against the pure risk of loss to the real property. However, the loan itself is a speculative business risk...that's not the function of insurance.

As an example, let's say the purchase price and loan amount for a home is \$200,000...for the sake of simplicity, we'll forget about any down payment. This \$200,000 represents *market value*, not insurable value. The cost to rebuild the home itself might be \$140,000, with the \$60,000 balance being the value of the land and other structures. The purchase price includes the value of land, all structures, and even other property that may not be covered by a homeowners policy.

The purchase price may also include the "value" of the location. I once looked at two new homes, both built from the same floor plan by the same contractor. The asking price for one of the homes was 50% higher than the other based SOLELY on the location of the home in a "preferred" neighborhood. The cost to rebuild the homes would be virtually identical.

Under a homeowners policy, the insurance company would never pay more than \$140,000 if the home was completely destroyed unless required to by a state's valued policy law (which is another reason for not insuring the loan amount). There has been no damage to the land or the "location value" (or at least the policy isn't going to pay that amount), so it would largely be pointless to insure the property for more than the structural replacement costs.

It does not serve the bank's interest in any way to be the mortgagee on a policy with a policy limit equal to the loan amount because neither the insured nor the bank will ever collect that amount. The policy will only pay an amount based on the valuation method included in the contract. Again, this is the case if no valued policy law applies...if it does, then the insured could actually profit from the loss by insuring the loan amount rather than the replacement cost of the property. This would violate one of the fundamental tenets of insurance and, conceivably, could create a moral hazard.

If an insurance company issues a replacement cost (or, worse, an ACV) policy with a limit greater than the actual cost to repair or replace, they may be in violation of the insurance laws in most states. I'm pretty sure all states require that rates/premiums be adequate, not excessive, and not unfairly discriminatory. What these banks are asking is that the insurance company issue a policy with an excessive premium (payment for coverage the insured can never collect without a total loss and triggering of a valued policy law, which has a likelihood of maybe 1-3%) and that's probably illegal.

For example, **Tennessee** has an "Unfair Competition and Deceptive Practices" statute regarding loan amounts that exceed the value of a building or structure:

"Lenders of money - Extenders of credit.

"(a) No person who lends money or extends credit may:

"(8) Require, in connection with a loan or extension of credit secured by real property, that the debtor procure insurance for the protection of the property for an amount that exceeds the replacement cost of the structures existing on the secured property at the time of the loan or extension of credit or, in the case of a construction or improvement loan, insurance which exceeds the value the structures are expected to have upon completion of the construction or improvements."

This law was enacted by an initiative of IIABA's state affiliate, the Insurors of Tennessee, in response to the situation described above.

So, as you can see, a lender should not be permitted to demand an insurance limit that exceeds the value of the property insured as defined by the insurance contract. The insured or lender should never receive more than the actual value of the damaged property. In addition, "over-insuring" the property could be illegal, by statute or contract.

Note: For another excellent article on this subject, and specific to **Florida** law, check out Insuring for the Mortgage Amount on the Florida Association of Insurance Agents web site. As the article explains, Florida Administrative Code prohibits a mortgage lender from requiring insurance in an amount that exceeds the replacement cost of the home:

"4-167.009 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."

Another state that has responded to this situation via insurance department directive is **Georgia**. According to Georgia Directive 98-PC-1, Establishment of Property Values and Corresponding Insurance Amounts on Mortgaged Properties Insured in Georgia (June 26, 1998):

"Land values may not be included in the computation when determining the amount of appropriate homeowners insurance because homeowners insurance does not insure the land on which the home is located. Therefore, such activities are in violation of O.C.G.A. 33-6-5(6)(A) which provides as follows: 'No person shall knowingly collect any sum as premium or charge for insurance, which insurance is not then provided or not in due course to be provided subject to acceptance of the risk by the insurer by an insurance policy issue by an insurer as permitted by this title.'"

The directive goes on to say that agents engaged in this practice can be fined from \$1,000-\$5,000 for each act and/or have his licensed suspended, revoked or placed on probation. Any insurer in violation of the law may have its certificate of authority suspended, revoked or placed on probation.

Following the publication of this article, we heard from several other states who have similar "over insurance" laws besides Florida, Georgia, and Tennessee...below is a summary listing of the other states we're aware of with "over insurance" prohibitions. If you are aware of others, please send documentation to Bill.Wilson@iiaba.net or via fax to 775-249-9290.

Arizona

ARS 44-1208. Loans secured by real estate; prohibited practices; insurance. Except for consumer lender loans regulated pursuant to section 6-636, for any loan that is secured by real property, a person shall not require as a condition of the loan that the borrower obtain property insurance coverage in an amount that exceeds the replacement cost of the improvements as established by the property insurer.

[Note: The statute covers only real property (not mobile homes) and does not include commercial buildings. For more information, go to: <http://www.azleg.state.az.us/ars/44/01208.htm>]

California

California Civil Code § 2955.5 says, in part:

- (a) No lender shall require a borrower, as a condition of receiving or maintaining a loan secured by real property, to provide hazard insurance coverage against risks to the improvements on that real property in an amount exceeding the replacement value of the improvements on the property.
- (b) A lender shall disclose to a borrower, in writing, the contents of subdivision (a), as soon as practicable, but before execution of any note or security documents.
- (c) Any person harmed by a violation of this section shall be entitled to obtain injunctive relief and may recover damages and reasonable attorney's fees and costs.
- (d) A violation of this section does not affect the validity of the loan, note secured by a deed of trust, mortgage, or deed of trust.

Connecticut

Statute 360-757 originated with public act PA 84-212 which prohibits a mortgage lender from requiring a prospective home buyer to obtain a fire insurance policy in excess of the home's replacement value, as a condition of granting a mortgage loan on residential property located in the state and secured by such a mortgage. The act was effective on October 1, 1984. On October 1, 2000, the statute was broadened by PA 00-95 to include flood insurance, extended coverage insurance, or any combination of insurance, including fire insurance.

Massachusetts

General Law, Chapter 183, Section 66 says, in part:

A bank, lending institution, mortgage company or any mortgagee doing business in the commonwealth, when making a mortgage loan, shall not require, as a condition of a mortgage or as a term of a mortgage deed, that the mortgagor purchase casualty insurance on property which is the subject of the mortgage in an amount in excess of the replacement cost of the buildings or appurtenances on the mortgaged premises.

Michigan

MORTGAGE LENDING PRACTICES (EXCERPT)

Act 135 of 1977

445.1602a Property/casualty Insurance as condition to loan; limitation on amount required; amount as condition of sale, transfer, or assignment.

[M.S.A. 23.1125(2a)]

Sec. 2a. (1) Except as provided in subsection (2), a credit granting institution that requires a mortgagor to maintain property/casualty insurance as a condition to receiving a mortgage loan shall not require the amount of the property/casualty insurance to be greater than the replacement cost of the mortgaged building or buildings.

(2) A credit granting institution may require an amount of property/casualty insurance that is required of the credit granting institution as a condition of a sale, transfer, or assignment of all or part of the mortgage to a third party. This subsection does not require that the credit granting institution anticipate a sale, transfer, or assignment at the time the mortgage loan is

made.

History: Add. 1995, Act 214, Imd. Eff. Nov. 29, 1995

North Carolina

58-63-25 "Unfair methods of competition" or "unfair and deceptive acts or practices"

The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance:

(13) Overinsurance in Credit or Loan Transactions. In connection with a loan or extension of credit secured by real or personal property or both, requiring the applicant to procure property and casualty insurance against any one risk which results in coverage which exceeds the replacement value of the secured property at the time of the loan or extension of credit. In connection with a secured or unsecured loan or extension of credit, requiring the applicant to procure life or health insurance against any one risk which exceeds the amount of the loan. In connection with a loan secured by both real and personal property, requiring credit property insurance, as defined in G.S. 58-57-90, on the personal property. For the purposes of this subsection, "amount of loan" shall be deemed to be the amount of the principal and accrued interest to be paid by the debtor including other allowable charges.

Rhode Island

CHAPTER 27-5 - Fire Insurance Policies and Reserves - SECTION 27-5-3.2

§ 27-5-3.2 Property insurance. No person, bank, or lending institution doing business in this state, whether acting under state or federal authority, which includes but is not limited to (1) a bank, savings bank, or trust company, as defined in this title, its affiliates or subsidiaries, (2) a bank holding company, as defined in 12 U.S.C. § 1841, its affiliates or subsidiaries, (3) mortgage companies, and (4) any other individual, corporation, partnership, or association authorized to take deposits and/or to make loans of money under the provisions of chapters 20, 21, 22, 23, 24, 25, 25.2, and 25.3 of title 19, making a mortgage loan, shall, as a condition of the mortgage or as a term of the mortgage deed, require that the mortgagor carry property insurance on the property which is the subject of the mortgage in excess of the replacement cost of any buildings or appurtenances subject to the mortgage; provided, that if a mortgage is sold, transferred, conveyed, or assigned, it shall be the responsibility of the holder of the mortgage to notify the insurance producer issuing the property insurance policy in writing of that sale, transfer, conveyance, or assignment. This notice shall be made in writing and shall be sent to the insurance producer within thirty (30) days of the sale, transfer, conveyance, or assignment by registered mail. In the event that the holder of a mortgage shall fail to notify the insurance producer who issued the property insurance policy that is in force, in writing, of that sale, transfer, conveyance, or assignment within thirty (30) days, the holder shall indemnify and hold the insurance producer harmless.

Virginia

The question posed was if a bank could force the consumer to have an insurance policy with the insured amount being the loan value even if this exceeds the value of the building. Under Virginia Banking code banks are not allowed to do this. The statutes does not reference personal or business loan so we would assume it applies to both.

VA Code- 6.1-2.6:1. Fire insurance coverage under certain loans not to exceed replacement value of improvements.

A. No lender shall require a borrower, as a condition to receiving or maintaining a loan secured by any mortgage or deed of trust, to provide or purchase property insurance coverage against risks to any improvements on any real property in an amount exceeding the replacement value of the improvements on the real property.

In this section, 'property insurance coverage' means insurance against losses or damages caused by perils that commonly are covered in insurance policies described with terms similar to 'standard fire' or 'standard fire with extended coverage.'

In determining the replacement value of the improvements on any real property, the lender may:

1. Accept the value placed on the improvements by the insurer; or
2. Use the value placed on the improvements that is determined by the lender's appraisal of the real property.

B. A violation of this section shall not affect the validity of the mortgage or deed of trust securing the loan."

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