White Paper

Financial Institutions

What's the Risk? Benefits of Insurance Tracking

Allied Solutions

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A sound risk management strategy for lenders should include a comprehensive insurance tracking program to ensure your secured collateral and your loan portfolio remain protected from loss. It is not enough for lenders to merely trust their borrowers will insure the loan collateral without verifying that insurance is in place. Depending on geographic location, up to 29% of motorists in the U.S. are driving uninsured.[1] In fact, over 1 in every 5 drivers is uninsured in Michigan, Washington, Mississippi, Florida, New Mexico, and Tennessee.[2] When borrowers make a personal choice to accept the financial risk of a potential loss, that decision can also have consequences for the lender, leaving you holding a lien on significantly devalued, or worthless, collateral. Are you prepared to absorb the costs when your uninsured borrower cannot afford to repair the collateral or pay their loan after a loss?

By failing to track insurance on your loan collateral you risk:

- Financial loss due to lack of insurance coverage
- Increased deficiency balances
- Liability exposure on lease portfolios
- Increased unmitigated exposure during natural catastrophes such as hurricanes, flooding, and wildfires
- Being unprepared for a shift in economic conditions that increase your uninsured rate

Using an outsourced tracking provider not only protects the lender against financial loss, but it can also cut down on your overhead expenses. On average, each vehicle collateral will result in 2.8 insurance policy mailings received by your financial institution's mailroom every year. This means for every 100,000 vehicle loans, 280,000 pieces of insurance mail need to be opened, sorted, and processed, and that effort can cost upwards to $150,000. Leveraging technology such as electronic data interchange (EDI) can reduce the volume of insurance mail and the corresponding costs by 80-90%.

Verifying coverage in response to a cancelled insurance policy or to file a claim on a repossessed collateral can also be costly. A tracking provider should be able to leverage robotics technology to automatically verify up to 75% of carrier policies; work that your staff may be currently performing manually. This not only reduces staffing costs but further increases your insurance data's accuracy and ability to reduce deficiency balances.

Mitigating the risk of uninsured or underinsured loan collateral has been a longstanding priority in the mortgage industry. Private investors and government sponsored enterprises (e.g., Fannie Mae) have implemented insurance monitoring requirements for their servicers. The intent of these requirements is to not only mitigate current risk of uninsured loss, but also to be prepared for catastrophic loss events or changes in economic conditions.

Regulations and Compliance Issues Related to Tracking Insurance

MORTGAGE TRACKING REGULATIONS

To ensure compliance with federal laws and regulations, mortgage servicers are required to have a flood insurance tracking program in place and must ensure adequate flood insurance is in force on all collateralized properties (with a few exceptions) located in a Special Flood Hazard Area (SFHA).[3] Credit may not be extended for any property in an SFHA until the lender confirms the consumer has obtained adequate flood insurance. Lenders are required to force-place flood insurance on collateral found to be underinsured or uninsured and regulators can impose fines on lenders for failing to comply with these requirements.

Lenders are also required to implement a tracking program for hazard insurance on Government Sponsored Enterprise (GSE) loans, such as Freddie Mac or Fannie Mae loans.[4] These programs have specific guidelines that lenders must comply with to ensure adequate insurance is in force on the collateral throughout the life of the loan.

These guidelines include:

- Having a process in place for monitoring the insurance on the property
- Placing coverage in the event a property is found to be uninsured

The Consumer Finance Protection Bureau (CFPB) requires lenders to act "with reasonable diligence to ascertain a borrower's hazard insurance status," prior to charging a borrower for lender-placed insurance.[5] The notice requirements set forth in the regulation are considered reasonable due diligence, but those requirements can only be undertaken if a lender has some sort of insurance tracking program in place.

AUTO TRACKING REGULATIONS

While no laws have been promulgated explicitly requiring lenders to implement insurance tracking on their auto loan collateral, it is possible for a regulator to consider a tracking program in the context of the safety and soundness of a lending institution. Knowing the insured rate of your loan collateral gives lenders the power to make sound decisions and act to mitigate potential financial loss before it happens. For example, having record of the most current insurance on a repossessed collateral enables the lender to file a damage claim with that insurer and reduce the deficiency balance. The lender can reduce the rate of uninsured collateral and increase those opportunities to reduce deficiency balances by enacting a policy of communicating with borrowers when they've been identified as not adhering to their contractual obligations to maintain adequate coverage.

Lenders should also consider the benefit of an insurance tracking program in precluding a claim that the requirement to maintain insurance coverage is not enforced fairly among borrowers. If a lender does not employ an insurance tracking program, it may lead to inconsistent enforcement of the insurance requirement under the loan contract. Lenders contractually obligate the borrower to provide and maintain acceptable insurance on the collateral and have a corresponding duty to ensure borrower abides by those terms. For example, a lender who "picks and chooses" when to enforce the insurance requirement may find that its process has an unequal impact on a class of borrowers, which could expose the lender to potential legal liability. An effective insurance tracking program ensures the terms of the loan agreement are uniformly applied to all borrowers and guarantees the lender is fulfilling its duties.

Implementing an insurance tracking program also supports public policy and personal responsibility by promoting an increase in liability insurance, in addition to the comprehensive and collision coverages required by the loan agreement. The National Highway Traffic Safety Administration reported over 36,000 motor vehicle related fatalities in 2019 and has estimated the economic impact of motor vehicle crashes at nearly $1 trillion per year.[6] More than ever, it necessary for drivers to maintain insurance to not only protect themselves, but everyone else on the road.

Learn more about the benefits of insurance tracking:
alliedsolutions.net/solutions/manage-risk.

White Paper Sources and Citations

[1] https://www.iii.org/article/background-on-compulsory-auto-uninsured-motorists

[2] Id.

[3] National Flood Insurance Act of 1968, the Flood Disaster Protection Act of 1973, as well as subsequent amendatory Acts. 12 CFR 22, 172, 208, 339, 614 & 760)

[4] Fannie Mae: Fannie May Servicing Guide. Freddie Mac: https://guide.freddiemac.com/app/guide/section/8202.8

[5] 12 CFR 1024.37(b) (official comment)

[6] https://www.nhtsa.gov/document/2015sae-blincoe-costsofcrashes2010pdf-economic-and-societal-impact-motor-vehicle-crashes

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