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The Sub-Prime Mortgage Crisis: Policyholders Must Be Attentive To Terms And Conditions As Contested Mortgage Guaranty Insurance Claims Rise

On April 29, 2008, real estate market data provider RealtyTrac reported first quarter 2008 foreclosures rose nationally 112% over the same period in 2007. This follows consecutive increases in foreclosures in the United States over the past eighteen months. Consequently, in addition to repurchases, financial institutions, mortgagees and investors increasingly look to mortgage guaranty insurance to recover losses caused by what has become known as the sub-prime mortgage crisis. Unfortunately, as claims begin to mount, credit insurers have become more resistant to payment for loans that are now in default. See, e.g., *Banker's Life Insurance Company v. Credit Suisse First Boston, et al.*, No. 8:07 CV-00690 (M.D. Fla. 2007) (involving a denial of claims made by a purchaser of mortgage-backed securities under a mortgage guaranty policy on the basis that the underlying mortgage loans were "fraudulent").

Given the substantial risks to policyholders and the growing pressure on insurance carriers to deny claims, it is important for insureds and beneficiaries of mortgage guaranty insurance and other credit risk policies to understand their contractual rights and obligations.

Mortgage guaranty insurance typically provides coverage for the risk of default by borrowers on insured loans. *Hinton v. Fed. Nat'l Mortgage Ass'n*, 945 F. Supp. 1052, 1055 (S.D. Tex. 1996). Private mortgage insurance is most common for transactions involving a high loan-to-value ratio. Generally, premiums for mortgage guaranty insurance are paid by the mortgagor; although, some insurers offer lender-paid mortgage insurance. In either case, it is usually the lender and its assigns, rather than the borrower, who are insured by the policy.

While each policy is unique, policies insuring mortgagees and their assigns often include detailed requirements with respect to providing notice of a borrower's default and the filing of a claim. For example, many policies require written notice to the insurer within a discrete period of time (usually between thirty and sixty days) whenever a borrower fails to pay even one monthly installment on an insured loan. Moreover, as a condition of coverage, some insureds are compelled to provide periodic reports on the status of loans in default and to pursue enforcement of loans, through foreclosure or other means, if the loans remain in default for a period of six months or more. Fortunately, once a claim is made by the insured, many mortgage guaranty policies insure the mortgagee's attorneys' fees up to a specified percentage of the loan's value.

In general, once the security for the insured loan is either acquired by the insured mortgagee or otherwise disposed of to third-parties, the insured must make a formal claim, again within a discrete period of time or risk forfeiting coverage. Upon submission of a written claim and calculation of the loss amount (as set forth in the policy), the insurer typically must pay within a certain number of days subject to the satisfaction of specified conditions, including the transfer of the security for the insured loan, if any, to the insurer.

Finally, mortgage guaranty insurance is often subject to various exclusions, including provisions denying coverage for claims that arise out of any dishonest, fraudulent, criminal or knowingly wrongful act by either the insured or the servicer of insured loans. Still other policies exclude coverage for claims resulting from the negligence of the insured, to the extent that such negligence was material to the acceptance of the insured loan or to the default by the borrower. However, as with all policy exclusions, the insurer bears the burden to demonstrate the application of the exclusions to a given set of facts. TEX. INS. CODE ANN. § 554.002. Furthermore, to the extent that there is any ambiguity in a policy's terms, all doubts must be resolved in favor of coverage for the insured. *Glover v. Nat'l Ins. Underwriters*, 545 S.W.2d 755, 761 (Tex. 1977).

If you would like assistance or more information regarding mortgage guaranty insurance claims or any other insurance related matter, please contact one of the Haynes and Boone Insurance Coverage Practice Group partners listed below.

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