



**Statement of
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on Behalf of the
Mortgage Bankers Association**

**National Association of Insurance Commissioners
Property and Casualty Committee
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Introduction

Good Afternoon. I very much appreciate this opportunity to address the Property and Casualty Committee of the National Association of Insurance Commissioners (NAIC).

My name is Catherine Rodewald and I am a Managing Director with Prudential Mortgage Capital Company. In this role, I am responsible for the servicing and asset management operations associated with Prudential Mortgage Capital Company's commercial real estate loan portfolios, as well as the organization's technology strategy and business systems. At Prudential, we hold and service almost \$50 billion in commercial loans.

I am here today at the request of the Mortgage Bankers Association (MBA) to discuss an issue that is of vital interest to my company and to the MBA – **insurance information transparency**. What we mean by insurance information transparency is the availability of insurance policy information to the borrower, lender, and loan servicer in a timely, accurate, and complete manner.

The objective of my presentation today will be to provide you with a window into the real estate finance sector that highlights the important role property insurance plays in the efficient operation of the real estate finance industry and the severe challenges faced by our industry when there is a lack of insurance information transparency.

The MBA

For those of you who may not be familiar with the MBA, it is a national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. MBA members provide over 70 percent of the nation's residential mortgages and 50 percent of its commercial mortgages. MBA represents the single largest domestic debt sector in the country. Our

membership of more than 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, commercial mortgage servicers, life insurance companies and others in the mortgage lending field.

The Real Estate Finance Industry

MBA represents both the residential and commercial real estate finance industries. Currently there is \$9.84 trillion of residential mortgage debt outstanding and \$2.76 trillion in commercial/multifamily debt outstanding. This debt finances the vast majority of single family homes, office, retail, industrial, and apartment buildings. This mortgage debt finances the buildings that house the businesses that are the engines for the nation's vibrant and diverse economy as well as the homes of most Americans. Actions that would undermine the residential and commercial real estate finance market, such as the lack of insurance information transparency, would not only impact the residential and commercial real estate finance sectors, these impacts would ripple through the economy as buildings and homes became more difficult and costly to finance and purchase.

Typical commercial mortgages are made on an 80 percent loan to value ratio, which means that at the time of loan origination 80 percent of the property value is reflected in the mortgage held by the lender and the remaining 20 percent is owner's equity. Commercial real estate lending is typically non-recourse meaning that in the case of a mortgage default the lender can only look to the underlying value of the property to recover its mortgage balance, not the assets of the owner. **Because most commercial real estate lending is non-recourse, lenders have an acute interest in preserving and protecting asset value. In order to protect their interest in their commercial real estate assets, lenders place paramount importance on requiring and verifying that uninterrupted insurance coverage is in place for the life of the loan.**

While residential lenders do have recourse against borrowers (depending on state law), the reality is that most borrowers are insolvent when the loan reaches foreclosure. As a result, the lender's only true means of recovering the debt is through the property.

In addition, both Freddie Mac and Fannie Mae, which have securitized 37 percent of single family residential mortgage debt outstanding, also require property insurance to be in place during the life of the mortgage. Other private investors also impose this standard. Failure to obtain required insurance can result in mandatory buy backs of loans from the secondary loan purchaser to the loan originator or servicer and the loan originator or servicer would have the full exposure to principal loss in the event of damage.

The Role of the Loan Servicer

An important constituency of the MBA is the loan servicer. The role of the residential and commercial loan servicer commences the day the loan is closed and ends when the loan is paid off. Between these events, the servicer is responsible for enforcing the loan documents and protecting the property, including activities such as collecting and dispersing loan payments, administering escrow and reserve accounts, preparing financial reports, monitoring and inspecting collateral, transferring ownership, and default

administration. Collectively, these responsibilities ensure that the underlying collateral is being properly maintained and the cash flow from mortgage payments is being properly disbursed to investors.

Servicers bear the contractual responsibility, as described in transaction legal documents, of ensuring that required insurance coverage is in place during the life of the loan. When insurance coverage is not in place, servicers are required to force place insurance coverage. Force placed insurance is expensive and is charged to the borrower. Loan servicing is an ongoing activity for the duration of the loan, which can range from 5 to 40 years. However, insurance coverage is typically purchased on an annual basis. Consequently, servicers are required to verify adequate insurance is in place on an annual basis, not just at the inception on the loan.

However, before a loan can be closed, lenders typically require evidence of insurance by either a copy of the insurance policy or the ACORD 28 form for commercial lenders or the ACORD 27 form for residential lenders. **Lender reliance on the ACORD 28 and ACORD 27 forms has increased over the years because complete insurance policies are seldom issued at the time of the loan closing.**

Why Insurance Transparency is Important

The borrower agrees in the loan documents to provide evidence of insurance in place. The servicer in turn works to verify the borrower has insurance in place. To expedite the process, servicers often work directly with the insurance agent to obtain proof of the borrower's insurance policy. The ability to help the customer (the borrower) meet the loan document requirement is an important goal of servicers. These servicer requirements exist regardless of the size of the loan amount or the loan product used. The servicer has the identical contractual responsibility for a \$500,000 or a \$50 million loan. This responsibility exists for all categories of commercial real estate loans.

ACORD 28 and 27 Background

Before discussing the changes to the ACORD 28 and ACORD 27 forms, I would first like to provide some background and context for the creation of these forms. For over 30 years, the courts and industry have recognized the need for the real estate finance industry to have evidence of insurance. ACORD 27 was drafted as a result of this acknowledgment.

However, after the events of September 11, it became clear that additional information was needed and the significance of policy language became evident. In the aftermath of September 11, insurers dropped terrorism insurance coverage and did not notify lenders or servicers when new annual insurance contracts were issued. This lack of notification or transparency placed a huge liability on lenders, who are listed on insurance contracts as co-payees or additional insured. This left servicers with the responsibility of having to review every insurance contract for each loan to verify that terrorism coverage was in place. This process was greatly complicated by not having a transparent process in place for insurance companies to notify servicers and lenders that terrorism coverage was in place.

This lack of transparency spurred the development of ACORD 28 and ACORD 27. ACORD Standard 28 - Evidence of Commercial Property Insurance (ACORD 28) was introduced on October 31, 2003 and was endorsed by the NAIC, the Council of Insurance Agents and Brokers (CIAB), and effectively met the requirements of evidence of insurance for major lenders and servicers, Freddie Mac and Fannie Mae. Likewise, ACORD 27 – Evidence of Personal Property Insurance met the standards for proof of insurance for Freddie Mac (ACORD 27). ACORD 28 and ACORD 27 are stand alone documents to be used by the real estate finance industry as a way to track property insurance coverage---such as terrorism, business interruption or mold coverage. ACORD 28 is intended to boost investor confidence, lower operating expenses and ultimately enhance liquidity in the marketplace. The ACORD 28 and ACORD 27 forms are important because they serve as a proof of coverage until the lender or servicer is able to obtain a copy of the insurance policy.

Since 2003, the ACORD 28 and ACORD 27 forms represented consensus documents that both the real estate finance and insurance industries teamed to carefully draft.

ACORD 28 and ACORD 27 Changes

Recent changes to the ACORD 28 and ACORD 27 forms introduce new disclaimers that specifically state that the forms are for information only and, therefore, threaten the forms' use as adequate proof of insurance. The prior version of the forms served as evidence of insurance. In addition, changes to the ACORD forms no longer obligate insurers to notify named parties of insurance cancellations. These changes create significant contractual and insurance compliance burdens for borrowers, closers and subsequently, loan servicers throughout the life of the loan. MBA seeks to preserve notifications to all policy insureds during the life of the loan, which is critical to effectuating information transparency and protection to property owners, lenders and investors.

Unfortunately, I must report that the changes made to the ACORD 28 and ACORD 27 forms were made without the notification, input, or consent of the real estate finance industry. This represented an alarming departure from the spirit of cooperation and consensus building that was the hallmark of the prior version of the forms.

Real Estate Finance Industry Reaction to ACORD 28 and ACORD 27 Changes

The reaction of the real estate finance industry to these unilateral changes to the ACORD 28 and ACORD 27 forms was swift and decisive. Organizations such as Freddie Mac recently issued a press release indicating that they would no longer accept the revised versions of ACORD 28 and ACORD 27. A major reason behind Freddie Mac's rejection of the revised ACORD 27 form was because the language regarding cancellation notices conflicts with the underlying insurance policy's mortgagee loss payee endorsement that all residential mortgage lenders require. That endorsement requires notification to the mortgagee in the event of policy cancellation. In effect, the revised ACORD 27 is at odds with required insurance policy language by both Freddie Mac and Fannie Mae. In addition, many commercial real estate lenders and rating agencies have rejected the revised ACORD 28 form.

Impact of ACORD Changes on Commercial and Residential Real Estate Lending

The changes on the ACORD 28 form have had a negative impact on the commercial real estate finance industry, especially the commercial mortgage-backed securities (CMBS) industry. The CMBS industry was started in the 1990s and has grown dramatically to where it now accounts for 20 percent of all commercial mortgage debt outstanding. The CMBS market acts in much the same way as the residential mortgage finance market: loans are originated and then pooled into securitizations that are then sold on the secondary market to investors. A notable difference between the residential and commercial mortgage-backed security markets is that commercial loans are generally much larger and much less homogeneous than residential loans.

Serving an important role in the CMBS industry are the rating agencies, which evaluate the credit quality of CMBS issues. They serve as gatekeepers to ensure that mortgages included in a CMBS meet certain rating requirements. Rating agencies are excluding commercial mortgages that have the revised ACORD 28 form in their documentation from being included in pools of loans that are being securitized.

This has had a dramatic impact on commercial real estate lenders. Many lenders originate commercial real estate loans with the intent to either securitize the loan themselves or sell these loans to companies that issue CMBS. These lenders typically originate and sell or securitize their commercial mortgages within 30 to 90 days of issuing the mortgages. This allows them to free up capital to lend on other commercial real estate projects. However, when lenders are not able to sell or securitize their inventory of commercial mortgages because of rating agency unwillingness to include mortgages in CMBS products with the revised ACORD form, these lenders are forced to keep these loans on their books. This prevents lenders from making new loans because their capital assets are tied up in mortgages that they cannot securitize. Think of this as a pipeline that is clogged, preventing anything from moving in or out of the pipeline. This has the potential to curtail lending, as well as slowdown the level of CMBS lending.

Ironically, this is also a problem for the insurance industry. On the investment side of the business, insurance companies make commercial real estate loans, as well as issue and purchase CMBS. In fact, insurance companies currently hold \$271 billion in commercial and multifamily mortgages. Consequently, activities that undermine the commercial mortgage and CMBS markets also undermine the investments of insurance companies.

With regard to residential lending, without the ACORD forms, lenders are faced with obtaining a copy of the policy at closing or --at a minimum-- a declarations page in order to satisfy the insurance requirements of investors. Obtaining such documents in a timely manner relative to closings is often difficult and may result in delayed closings, which could reflect negatively on the insurance industry. Pressure imposed on lenders to obtain policies at closing will likely trickle down and also strain insurance agents' and brokers' resources. On an ongoing basis, the inability to get insurance policies by the annual renewal date could cause more borrowers to be forced placed when completely unnecessary. This is not a desirable result.

Working Toward Resolution – Real Estate Finance Industry Teaming with the Insurance Industry

Given that both the real estate finance and insurance industries both serve the same customer, the borrower, MBA has been reaching out to important insurance industry stakeholders to craft a solution to the insurance information transparency problem. The first step in this process was to discuss with NAIC staff MBA's concerns about the insurance information transparency issue and action steps for presenting this issue to insurance commissioners.

On November 7, a team of MBA representatives met with Alabama Insurance Commissioner, Walter Bell, in Montgomery, Alabama. Commissioner Bell started his one-year term as NAIC President in December. The meeting with Commissioner Bell addressed industry concerns over the recent changes to the ACORD 28 and ACORD 27 forms as evidence of insurance and enhancing information transparency and cooperation between the insurance and real estate finance industries. The heightened importance of such transparency in light of recent natural disasters and the expiration of TRIEA next year were emphasized. We were encouraged that Commissioner Bell agreed to put this topic on the Property and Casualty Insurance Committee Agenda for this meeting and he also offered to arrange meetings with insurance industry trade groups.

On November 29, MBA staff met with representatives of the American Insurance Association (AIA) to discuss insurance transparency issues. Changes to the ACORD 28 and 27 were discussed from the real estate finance and insurance perspectives. Both parties agreed to work towards finding a solution to the recent changes to the forms that are acceptable to both the real estate finance and insurance industries.

The MBA stands ready to work with the insurance industry to craft a solution for the insurance transparency issue.

Working with the NAIC on Insurance Information Transparency

My comments today were intended to provide some background and insight as to the importance that insurance information transparency plays in the real estate finance industry. We are in the process of working with the insurance industry to resolve this problem.

Moving forward, we would greatly appreciate the opportunity to report to you at your next meeting the progress that we have made in securing the cooperation of the insurance industry to resolve the insurance information transparency problem. At that time we would like to be able to report on substantial progress made on a joint real estate finance and insurance industry solution or provide recommended actions that the NAIC could take to create greater insurance information transparency. On behalf of the MBA, I greatly appreciate your time and attention on this important matter.